Major Electricity Users' Group

28 October 2014

Dr John Rampton
General Manager Market Design
Electricity Authority

By email to submissions@ea.govt.nz

Dear John

Working paper – TPM: Problem Definition

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Authority working paper[1] "Transmission Pricing Methodology: Problem definition" dated 16th September 2014.
2. MEUG sought advice from the New Zealand Institute of Economic Research (NZIER). A copy of the NZIER report "Transmission pricing problems, Assessment of the 2014 EA problem definition" 28 October 2014 is attached and should be read as part of MEUG submissions.
3. Members of MEUG have been consulted in the preparation of this submission. This submission is not confidential. Several MEUG members will be making separate submissions.

The working paper and MEUG's summary view on the TPM problem definition

4. The purpose of the working paper is to seek feedback on the problem definition because[2] "there is a need to better articulate the problem definition in the second issues paper". The latter is to be published mid 2015.
5. MEUG's submission of 28th February 2013 on the first consultation paper of October 2012 stated[3] "We do not accept that problems with the current TPM for allocating sunk costs are material enough to justify significant changes where the efficiency gains from re-arranging sunk costs are not obvious".
6. The question is whether the latest working paper intended to better articulate the problem definition has altered our view in February 2013? The answer is not much.

[1] Document URL http://www.ea.govt.nz/dmsdocument/18474 at http://www.ea.govt.nz/development/work-programme/transmission-distribution/transmission-pricing-review/consultations/#c13929
[2] Ibid, paragraph 2.10
[3] MEUG to EA, Consultation Paper – TPM: issues and proposal, 28th February 2013, paragraph 7

7. The latest working paper partly re-articulates the problems set out in the October 2012 paper but more importantly changes the ranking of perceived problems. In other words the problem definition has shifted. NZIER have summarised how the problem definition has been revised in table 1 on page 4 of their report.

8. Some parts of the revised problem definition and the analysis that underpins that have improved. For example, apart from one special case, the Authority has decided not to use the Generation Expansion Model (GEM). That simplification is a good step.

9. Other parts of the analysis still have shortcomings. NZIER state (paragraph 21) –

> "However, in the same manner as for the 2012 paper we again regard the inefficiencies described in the Authority 2014 paper as illustrative rather than representative of the system and not definitive. Many of the inefficiencies are largely assertions that use examples considered through the narrow perspective of transmission charges, as opposed to real world evidence to identify and quantify the problems."

Key transmission problems and therefore solutions are wider than just TPM

10. Even if changes were made to TPM to overcome all perceived problems with allocation of existing charges we don't think that is enough to solve other important problems with transmission investment decision making.

11. MEUG's submission of 28th February 2012 quoted in paragraph 5 above went on to say:

> "We do believe the previous regulated processes for Transpower to gain approval for capital expenditure failed end consumers. The jury is out on the more recent shift of responsibility for regulation of Transpower to the Commerce Commission and MBIE. There is also a fundamental policy question as to whether Transmission assets that are clearly uneconomic should be written down. This is an increasingly realistic scenario as peak demand growth for grid services may decline with the emergence of new demand side response and distributed generation technologies."

12. The next two sections discuss what's happened on these two issues since February 2013. The last section discuses a related topic of transmission charges being passed through to all classes of consumer.

The prior regulatory approval regime for transmission investments failed consumers

13. We still consider that the capital expenditure approval process administered by the Electricity Commission failed consumers.

14. It wasn't the Electricity Commission that failed consumers rather the regulatory regime they had to administer. That regulatory regime included postage stamp recovery of interconnection charges across all consumers nationwide and similar for HVDC charges across South Island generators above a de minimus. If in the past when those investments were being considered for approval there had been more certainty that future transmission prices would have a beneficiaries-pay component then other lower cost options may have been proposed by parties likely to face higher transmission charges.

15. The approval regime used by the Electricity Commission subsequently shifted to the Commerce Commission. There were some modifications to that approval regime but there has been no amendment to the TPM to ensure parties that benefit from transmission investments in the future know they will bear all of those costs. The opportunity to synchronize improvements to the TPM and the review of the Transpower Capital Expenditure Input Methodology (IM) and other IM relevant to Transpower to be completed by end of 2017 must be explored.

16. One of the beneficiaries of new transmission investment is Transpower's shareholders. The review of IMs over 2016-17 should also consider if Transpower's shareholders should bear some risk for stranded assets. Likewise for distributors.

Treatment of existing uneconomic transmission assets

17. In the MEUG submission of February 2013 we signalled an intention to seek support from Ministers "to consider under what circumstances might clearly uneconomic existing grid assets necessitate a write down in value by Transpower." Note the difference between this issue relating to existing uneconomic transmission assets and the preceding discussion in paragraphs 13 to 16 in relation to mitigating decisions leading to uneconomic line investments in the future.

18. Following our submission in February 2013 MEUG corresponded with Ministers[4] on this topic and we will continue to do so.

19. In various forums MEUG has asked the question about the treatment of existing uneconomic transmission assets including in an Energy News opinion piece on 5th December 2012. That article noted two benefits of Transpower writing down existing uneconomic assets. First if charges are not adjusted to reflect market values then investment and operational decisions by participants based on excessive charges will be distorted. Second the moral hazard risk whereby if Transpower is not held to account for making poor prior decisions then it will have no incentive to change decision making behaviour in the future.

20. MEUG has raised these points because we think arguments that treatment of charges for existing transmission assets is only about re-allocation of costs and there are no efficiency effects have not considered the case of existing uneconomic assets. There may be offsetting economic efficiency arguments against allocating the costs of existing uneconomic assets to Transpower's shareholders. The point MEUG has made is that the topic needs to be debated not sidelined.

21. For illustrative purposes the table below considers two extreme cases of existing transmission assets: one being economic the other not. It's the uneconomic asset that arguably creates the most risk of distortionary or inefficient behaviours and undermines confidence in the transmission approval decision making process. Fixing problems that lead to uneconomic transmission assets should be a higher priority than re-allocating charges for existing economic assets:

Type of existing transmission asset	**Economic** (benefits > annual charges) e.g. Pole 2	**Uneconomic** (annual charges >> benefits) e.g. NIGUP
TPM problems?	small	larger
Durability risk?	small	higher

22. The treatment of existing uneconomic transmission assets remains a live topic for MEUG and may have some bearing on options to review the TPM.

[4] MEUG letter to Ministers, Improving Productivity in the electricity sector, 17th June 2013. Ministers reply of 26th August 2013. MEUG letter to Ministers "Congratulations on Ministerial appointment" dated 14th October 2014.

Price signals to all users' of transmission services matter

23. The working paper reinforces the need for prices signals to all users' of transmission services that reflect the cost of transmission used by each user. By users' of transmission services we mean not just end consumers but also generators. The pass through of transmission prices will be considered in the Authority's Distribution Pricing Review (elevated to a second priority project for 2014/15). That review coupled with work on the Retail Data Project (a top six project) and Transparency of Consumer's Electricity Charges (another second priority project) should consider if, and if so how, transmission charges should be passed through.

Concluding comments

24. The working paper correctly states[5] "It is important to note here that there is no perfect TPM charge." It is difficult to comment about existing TPM problems without wondering if alternatives such as a SPD methodology based approach (or hybrid) might create other problems in respect of prices for existing transmission assets. As we submitted in February last year this submission echoes that uncertainty. Similarly there is some uncertainty how broader problems with transmission investment decisions in the past might be mitigated in the future. There is an opportunity to synchronise the planned review of various Input Methodologies in 2016-17 with changes to TPM that should be explored.

Yours sincerely

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Executive Director

[5] Working paper, paragraph 8.8