MAJOR ELECTRICITY USERS' GROUP

24 February 2017

Dr John Rampton
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By email to submissions@ea.govt.nz

Dear John

Transmission Pricing Methodology: Second issues paper: Supplementary consultation

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Authority (EA) "Transmission Pricing Methodology: Second issues paper, supplementary consultation paper" 13 December 2016.[1] For brevity we refer to this paper as the TPM refinements paper.
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential.
3. This submission should not be taken as representing the views of individual MEUG members. Members may make individual submissions. In such case those submissions will represent the views of those major users.
4. This submission comments on aspects of four specific topics:
   a) The proposed refinements to the guidelines;
   b) The indicative impact on future prices;
   c) The effect on the Cost-Benefit-Analysis (CBA) of the proposed refinements; and
   d) A reminder of the constraint on achieving a durable solution due to the option of Transpower bearing asset write-offs being outside the remit of the EA.

[1] URL http://www.ea.govt.nz/dmsdocument/21572 at http://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/transmission-pricing-review/consultations/#c16277.

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Part a) MEUG comments on the proposed refinements to the guidelines

5. MEUG last submitted in July 2016 that:

> "The proposed guidelines should set out the outcomes the EA expects any TPM to achieve. The proposed guidelines are overly prescriptive and should not constrain Transpower's ability to design a TPM that achieves the outcomes the EA wants to see."[2]

6. The proposed refinements include changes that reduce the prescription and constraints on Transpower considering options. This is especially relevant in the critical topic of the allocator for residual costs. MEUG therefore welcomes this proposed refinement.

7. In July last year MEUG also submitted:

> An example of the type of outcomes the proposed guidelines should specify is "transmission prices should, as far as practicable, be service-based and cost reflective" and the TPM "should be practicable and involve reasonable transaction costs[3]."[4]

8. MEUG welcomes proposed new guideline 4 (c) that takes this submission into account:

> "Guideline 4. To be consistent with the Authority's statutory objective specified in section 15 of the Electricity Industry Act 2010 as required by clause 12.89(1)(b) of the Code, the TPM must be directed at –
>
> …
>
> (c) in order to achieve the objectives in paragraphs (a) and (b), setting charges in a way that is as cost-reflective and service-based as is practicable in the circumstances."

9. The guidelines are silent on expectations that Transpower will reduce the residual - an important design outcome. EA has commented in discussions about the TPM that it expects the residual to be reduced over time. It is insufficient to simply assume this will happen and omit this expectation from the guidelines. Transpower should be required by the EA to actively seek to minimise the residual over time. MEUG therefore suggests a new sub-paragraph in guideline 4 as follows be included:

> "Guideline 4. To be consistent with the Authority's statutory objective specified in section 15 of the Electricity Industry Act 2010 as required by clause 12.89(1)(b) of the Code, the TPM must be directed at –
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> …
>
> (e) minimising, as far as is practicable, the residual on an ongoing basis."

[2] MEUG submission to EA, 26 July 2016, paragraph 15.
[3] EA Second issues and proposal paper, 17 May 2016, paragraph 38.
[4] MEUG submission to EA, 26 July 2016, paragraph 15

10. Another important outcome that MEUG suggests needs to be set as part of the overall design and implementation criteria is to have greater transparency on the value and make up of assets that cannot be allocated to a sub group of beneficiaries or are under-utilised and by default costs related to these assets are recovered through the residual. The resulting detailed cost allocation of assets in the residual must be transparent in the monthly billing to each designated transmission customer. That transparency will assist stakeholders to monitor progress toward minimising the residual based allocation of costs from current assets as well making the lessons from these decisions more visible to both Transpower and other stakeholders when future grid investment decision are considered. To strengthen the incentives and accountability of Transpower managers and Board in future investment decisions MEUG proposes a new sub-paragraph in guideline 4:

> "Guideline 4. To be consistent with the Authority's statutory objective specified in section 15 of the Electricity Industry Act 2010 as required by clause 12.89(1)(b) of the Code, the TPM must be directed at –
>
> …
>
> <u>(f) designing and reporting the calculation of the residual so that the value and make-up of assets included in the residual are identifiable in monthly billing to promote accountability of future decisions through greater transparency</u>."

11. To be durable the allocator for the residual should consider the effect on end consumers not just designated transmission customers. We think the EA intends Transpower to consider the effect on end consumers consistent with how the EA has done so when deciding new TPM guidelines. To give clear direction to Transpower that in considering various options for the residual allocator the option of using end consumer load characteristics can be considered MEUG proposes changes to guideline 32 as follows:

> "Guideline 32. The method for calculating the residual charge must –
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> (a) use load to identify designated transmission customers <u>and end consumers</u> that must pay the residual charge, and the extent to which those customers must pay; and
>
> (b) …
>
> (c) result in broadly equivalent charges to ~~customers~~ <u>consumers</u> that are in broadly equivalent circumstances; and
>
> (d) To the extent that it can be economically achieved, be designed such that a customer's residual charge will not change as a result of the customer's actions or the actions of another party other than Transpower, such that it does not create incentives or opportunities for designated transmission customers <u>and end consumers</u> to inefficiently avoid the residual charge; and
>
> (e) be related to the size of the load of each designated transmission customer <u>and end consumers</u> so that the allocation of charges is durable; and
>
> (f) …"

12. Guideline 33 allows Transpower to propose an allocator for the residual that can be either historical anytime maximum demand (AMD) or another method. It is not clear that Transpower may consider a hybrid method using AMD and or other allocators. To be clear MEUG propose additional text for guideline 33 (b):

> "Guideline 33. The method for calculating the residual charge must be one of the following –
>
> (a) historical anytime maximum demand;
>
> (b) another method or methods;

13. Changes in transmission prices as a result of a change in the TPM are not intended to be completely accomplished on say 1 April 2020. The refinements paper and the guidelines propose a two-step process with some changes to pricing coming into effect 1 April 2020 and other changes to pricing implemented as quickly as practicable after this date. MEUG recommends the EA give Transpower clear direction on the boundary between changes post 1 April 2020 to be implemented under a new TPM and changes that may arise in the interim that are efficient operational TPM proposals that will need to be considered in a parallel code change path. MEUG is not anticipating any operational changes and indeed we want the current TPM review process to be sufficiently comprehensive to ensure Transpower can have time after 1 April 2020 to implement the second step improvements to pricing. Nevertheless, it may be prudent to consider and give certainty to Transpower and the industry on how any unforeseen operational TPM changes would be considered.

Part b) MEUG comments on the indicative impact on future prices

14. MEUG welcomes the EA, other regulators and government agencies and departments explaining proposed major policy options and draft decisions in terms of the effect on end consumers. This is no easy task. In most cases the party best able to interpret policy proposals and how they may affect different consumers are those government entities. For the proposed TPM guidelines the EA is the party best placed to estimate possible price and other effects on end consumers. To that extent we welcome the EA providing indicative values.

15. However, we have two points to note on the indicative impact on future prices in the TPM refinements paper.

    a) The recent revisions to the estimates of the Area-of-Benefit (AoB) charges due to what appears to us to be a relatively small correction in the SPD data inputs, had a material change in many estimates for individual customers of Transpower. MEUG does not seek to remove SPD as an option Transpower can consider because other options may also have material shortcomings. However, MEUG suggests that greater transparency about the modelling inputs, and assumptions would assist with stakeholders to understand potential impacts on their businesses and the charges they may face.

    b) The use of only two scenarios, the first assuming possible decreases in WACC and the second no changes in WACC, has caused confusion and diverted debate to a narrow possible range of scenarios. MEUG expects Transpower in developing the TPM to conduct a robust sensitivity test of any scenarios.

Part c) MEUG comments on the effect on the CBA of the proposed refinements

16. Advice from NZIER to MEUG on the last consultation paper noted:

> "Although the net present value for the changes modelled by Oakley Greenwood is likely to be positive in most cases we expect that it will be much lower than the $200 million estimated by Oakley Greenwood."[5]

17. MEUG did not ask NZIER for a new report on the CBA discussion in the TPM refinements paper because our initial view was little had changed and therefore the CBA was still likely to be positive though probably not as positive as the EA expected. MEUG is also aware that the CBA relates to the likelihood the guidelines will discover the optimal TPM. The removal of unwarranted prescription with the proposed refinements is a step in the right direction to discovering a better and ideally an optimal TPM.

18. NZIER as advisors to MEUG were in attendance or privy to several meetings by EA staff with the MEUG Executive Committee, various email correspondence between the EA and MEUG and MEUG members, informal meetings between the EA and MEUG Executive Director and other relevant discussions. Following that engagement and after discussion with NZIER MEUG decided that the initial views of MEUG on the CBA in the TPM refinements paper noted in the preceding paragraph are sufficient.

19. The above views on the CBA supporting the proposed guideline should not be taken as MEUG's view on the CBA that will be necessary when the EA consults on the proposed TPM pursuant to cl. 12.92. There will need to be an order of magnitude step-up in the robustness of that CBA with absolute clarity on the level of Transpower charges over a sufficient number of years and scenarios to be relevant to end consumers and users of transmission making investment decisions. This will not be a trivial exercise as the effect on non-grid connected consumers, that is end consumers connected to distribution networks will need to be clarified. This will require distributors to co-operate with Transpower to assist its analysis.

20. It is essential Transpower consult when preparing a proposed TPM. Our experience with the last operational changes to the TPM has been that Transpower wish to and do consult. Nevertheless, it will be prudent for the EA when publishing guidelines to set out expectations for consultation by Transpower and include expectations on distributors also to assist Transpower estimate the effect on end consumers as discussed in the preceding paragraph.

[5] NZIER report to MEUG (part of MEUG submission to the EA), July 2016, p16

Part d) MEUG reminder of the constraint on achieving a durable solution due to the option of Transpower bearing asset write-offs being outside the remit of the EA

21. The EA is constrained in the options it can consider to improve TPM because the Commerce Commission, not the EA, regulates whether Transpower or consumers as a whole should bear the cost of uneconomic assets. This was not an issue MEUG or any other party asked the Commerce Commission to consider in the Input Methodology (IM) review that ended December 2016 because it has been considered to be in the "too-hard-basket". Instead for the IM review issues of uneconomic assets being stranded were considered at the distributor level in relation to emerging technologies and hence changing demand elasticities for line services across all consumer classes. The Commerce Commission, MBIE and EA have various on-going work-streams relevant to this issue.

22. While the immediate focus of policy makers and regulators is on distribution level effects of possible asset or network stranding MEUG notes the grid may not be immune to an increasing portion of Transpower's Regulated Asset Base being uneconomic. For example, the System Operator, a fully owned Transpower entity, has noted:

> "Demand varies from year to year, but the trend in recent years has been a decrease in electricity demand of approximately 0.2% per year, on average."[6]

23. Should this trend continue the question of whether the option of Transpower bearing asset write-offs will start to gather momentum.

Concluding comment

24. MEUG members are answerable to investors, shareholders and boards and must be able to explain changes in their input costs to those who have a stake in their businesses. Therefore, the TPM must be transparent and translatable to those who must bear the final costs.

Yours sincerely

John Harbord
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Major Electricity Users' Group

[6] System Operator, web page "Electricity Demand" downloaded 1 February 2017, https://www.transpower.co.nz/system-operator/security-supply/electricity-demand