BusinessNZ
GROWING PROSPERITY AND POTENTIAL

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Submissions
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Transmission Pricing Methodology: Second Issues Paper, Supplementary consultation

BusinessNZ is pleased to have the opportunity to provide a submission to the Electricity Authority on its consultation paper entitled 'Transmission Pricing Methodology: Second Issues Paper, Supplementary Consultation' dated 13 December 2016.[1]

Introduction

We support the on-going work of the Electricity Authority in developing the new Transmission Pricing Methodology (the 'TPM') if not all aspects of what has been proposed. In undertaking its work, our members collectively seek to be assured that the proposal continues to provide a better outcome than the status quo.

BusinessNZ has not responded to all of the refinements outlined by the Electricity Authority, leaving many to be addressed by those of its members who have particular and strongly held (in some cases opposing) interests in the specific detail of the matters raised. However, BusinessNZ has a number of issues it considers might warrant additional attention prior to the Electricity Authority finalising the proposal it has laid out. These issues are set out below.

[1] Background information on BusinessNZ is attached in Appendix One.

Comments

<u>The split between the Area of Benefit and Residual</u>

Implementation of the Area-of-benefit (AoB) should see the costs imposed on transmission customers reflect the benefit from the transmission services received provided Transpower accurately identifies the beneficiaries. This is likely to be more durable than the status quo.

With respect to the residual, the amount of revenue to be recovered with the residual charge is meant to equal Transpower's maximum allowable revenue less the revenue recovered from all of the other charges included in the TPM. The expectation is that the residual will reduce over time as new transmission assets are built and existing assets are replaced and refurbished. This is consistent with charges that are cost reflective and service based. Given this, we support an approach that actively and transparently provides the right incentives to Transpower to allocate assets to the AoB charge where benefits can be accurately identified and to the residual where they cannot be. This includes support for:

a) the expansion of assets that will qualify for inclusion where this is practicable. As far as reasonably possible the cost of the grid should be met under the proposed AoB. If a customer is able to benefit from transmission assets then a commensurate level of the cost of the asset should be allocated to that customer; and

b) greater transparency of what lies in the residual. This includes, amongst other things, the separate identification of residual common costs.

Neither (a) nor (b) however, obviates from the need for an allocator for the residual that is fully appropriate to the task of avoiding incentives for inefficient investment in the interconnected grid and inefficient investment by grid users, while having minimal impact on use in the short term of the interconnected grid and operation of the electricity industry.

Finally, we note (again) the somewhat arbitrary $5million threshold to distinguish between high value and low value transmission investments. In order to simplify the overall approach, BusinessNZ suggests that subject to overarching requirements across the calculation of all of the AoB to minimise transaction costs, understandability, etcetera that Transpower should be required to allocate *all* costs on the basis of the set standard method unless it cannot reasonably do so. Only at that point should Transpower use a 'simplified' method. Such an approach would be consistent with the greater flexibility afforded Transpower in the refinements paper.

Charges following load

We are perplexed by this proposal. We understand its intent – that load cannot game the system – but on the face of it, seems not to reflect either:

a) the complexity involved in businesses in making such decisions (they are not taken lightly);

   or

b) the efficacy of the Electricity Authority's proposals to send efficient signals to load to act appropriately.

In the second issues paper, the Electricity Authority says:

> "The residual charge has been designed to minimise incentives on transmission customers to invest in more costly alternatives to avoid the charge." (para 115)
>
> and
>
> "the proposed area-of-benefit charge would avoid incentives for inefficient investment in the interconnected grid and inefficient investment by grid users ….." (para 7.192)

The Electricity Authority appears to be signalling that load will be motivated to avoid the new charges, even though the residual is specifically designed to be a lump sum non-distortionary tax, and the low probably of shifting actually occurring. While not intended to be perceived as such, this proposal has the hallmarks of a punitive penalty for exercising a legitimate business decision. It is also novel with respect to other forms of infrastructure. If the core problem is that the TPM is sending inappropriate signals (which the Electricity Authority points out will not be the case) then the TPM should be amended to correct this.

Prudent Discount

In our previous submission we observed that the Electricity Authority's proposed changes – while well intentioned - might miss the mark. The Electricity Authority seems to agree. We support the changes proposed noting that the guidelines allow for a discount to be applied for where transmission customers can demonstrate that they would face a cost higher than stand-alone cost.

LRMC-based Charge

We remain of the view, outlined in our previous submission that removing a locational price signal such as RCPD could potentially remove the signal to avoid transmission services and cause an unintended spike in demand that had hitherto been suppressed, bringing on investment that is inefficient. However, we also considered that RCPD sent too strong a signal, in turn causing an inefficient outcome. The proposed guidelines provide for Transpower to consider the introduction of an LRMC charge as one of the additional components. We consider that such a charge could be relatively easy to implement but would need to be removed from the AoB charge post investment in order to avoid consumers paying for a transmission upgrade twice.

The Price Cap

We welcome the proposal to introduce a price cap. We consider that this is a necessary safety-valve mechanism especially in light of the additional flexibility now afforded to Transpower in the implementation of the TPM guidelines. However, we note the following:

a) the calculation of the price cap and its impact and distribution is highly assumption dependent. Putting aside the uncertainty surrounding the final shape of the guidelines themselves, other examples are demand growth and the inclusion of an estimated WACC based on current interest rates (as a matter of good regulatory practice, we would suggest that the Electricity Authority not incorporate into its analysis highly uncertain outcomes based on decisions not yet made by other regulators);

b) it is unusual to propose a cap on one thing (transmission costs) but to make it relative to something else (total energy costs). We note that 3.5% of the total costs will still potentially allow for large transmission cost increases but acknowledge that tighter price caps would prolong the transition and place an unfair burden on those who seek to have the current subsidy unwound by increasing the amount of the residual; and

c) it is unclear how the price cap clauses in the draft guidelines will work if the TPM is not introduced in the 2019/20 pricing year. It may be more appropriate to phrase this around the year in which the TPM commences, or some such similar wording.

Valuation Methodology for AoB Assets

We note the proposal that the charges for the AoB will be set such that in each year they are a constant portion of the historic cost of that asset indexed forward to the relevant year (indexed historical cost). We note that the risk of double charging still exists for some parties who have previously paid charges for those assets calculated on the basis of depreciated historic cost values. The Electricity Authority needs to assure itself that the principle of cost reflectivity to which it aspires is robust at the level of the individual asset and it does not over-recover in respect of specific assets.

A Note on Process

We are encouraged by the greater flexibility afforded to Transpower in the implementation of the revised guidelines, but we note that this flexibility is now substantial, often falling to Transpower to develop a method that is consistent with a high level set of principles. This makes the process that Transpower uses to develop what it seeks to implement extremely important. We continue to urge transparency and consultation on the process Transpower develops and as it executes its work.

We also recognise that there is still much work to be done by the Electricity Authority and we continue to urge it to continue to listen to the views of its stakeholders, and be as open and transparent as possible in this, its most complex of regulatory undertakings.

We are encouraged by the Electricity Authority in its willingness to demonstrate it is listening to feedback, and where it thinks appropriate making adjustments to the guidelines. However, this is a complex issue with all parties coming to terms how the revised guidelines will apply in practice. Signalling to stakeholders that the guidelines are in their best long term interests is different to stakeholders understanding and believing it to be true. Core to this will be whether the Electricity Authority can convince a hypothetical disinterested, but fair-minded observer, reviewing the outcome in good faith, that the changes are efficient.

Summary

We welcome the refinements paper and the recognition of some of the points of detail we raised in our previous submission. Regardless of what one thinks of the draft methodology and its potential outcome, it demonstrates a dynamic process whereby the Electricity Authority is listening, and where it thinks appropriate, responding to the issues and concerns of submitters. It is important that the Electricity Authority continues to do so.

We continue to urge the Electricity Authority to ensure that overall its changes remain consistent with its principles of being cost reflective and service based.

Yours sincerely

John Carnegie
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BusinessNZ

APPENDIX ONE: ABOUT BUSINESSNZ

BusinessNZ is New Zealand's largest business advocacy body, representing:

- Regional business groups EMA, Business Central, Canterbury Employers' Chamber of Commerce, and Employers Otago Southland
- Major Companies Group of New Zealand's largest businesses
- Gold Group of medium sized businesses
- Affiliated Industries Group of national industry associations
- ExportNZ representing New Zealand exporting enterprises
- ManufacturingNZ representing New Zealand manufacturing enterprises
- Sustainable Business Council of enterprises leading sustainable business practice
- BusinessNZ Energy Council of enterprises leading sustainable energy production and use
- Buy NZ Made representing producers, retailers and consumers of New Zealand-made goods

BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy and services for enterprise, BusinessNZ contributes to Government, tripartite working parties and international bodies including the International Labour Organisation (ILO), the International Organisation of Employers (IOE) and the Business and Industry Advisory Council (BIAC) to the Organisation for Economic Cooperation and Development (OECD).

The BusinessNZ family

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