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Graham Scott
TPAG Chair
c/- Electricity Authority
2 Hunter Street
WELLINGTON

By email: submissions@ea.govt.nz

Dear Graham

Shifting HVDC costs to consumers not supported

Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide a submission to the Transmission Pricing Advisory Group (TPAG) on the "Transmission Pricing Discussion Paper" dated 7 June 2011.

Genesis Energy does not support the TPAG majority recommendation that the costs of the inter-Island high voltage direct current (HVDC) link should be shifted from South Island generators to electricity consumers.

We consider that the modelling commissioned by TPAG does not demonstrate that there would be a clear and material efficiency gain from removing the HVDC charge. In the absence of such evidence, we cannot support a recommendation that would transfer wealth from consumers to South Island generators.

We are also concerned that removing the HVDC charge now would be inconsistent with good regulatory practice. The current transmission pricing methodology was settled in 2007 following a decade of dispute and there has been no material change in circumstances to prompt revisiting the pricing methodology now. We have consistently supported investigation into whether enhanced locational signalling would bring efficiency gains but do not support simply unwinding the 2007 decision.

We note that at the TPAG briefing[1] it was mentioned that the Electricity Authority ("the Authority") was prompted to form TPAG due to representations that there was a new consensus within the market regarding the HVDC charge. We wish to confirm for the record that Genesis Energy was never party to any such consensus or understanding. We are troubled by any implication that we would be complicit in an understanding amongst suppliers aimed at shifting costs to our customers.

The current review has been a costly diversion for the Authority and market participants at a time when there are more productive work streams that could have benefited from greater urgency (for example, scarcity pricing, locational price risk management, demand-side participation, market information and the distribution contracting environment). As well as this opportunity cost of committing resources to another review of the HVDC charge, there is a cost associated with the regulatory uncertainty that a change to the HVDC charge would bring. We consider that changing the HVDC charge now would demonstrate receptiveness to lobbying rather than adherence to principles of consistent, principled decision making.

Generation Investment Efficiency Gain

The majority view of the TPAG is that there would be a clear and material efficiency gain from shifting HVDC costs to consumers, with the main efficiency gain expected to be more optimal generation build schedule. Modelling indicates a gain of around $14 million to $64 million may be possible.

We consider that this does not provide sufficient evidence of a clear and material efficiency gain given:

- the net present value of the modelled generation build is on the order of $7 billion;
- the modelling assumes no offsetting improvements in transmission investment would arise from beneficiaries (South Island generators) bearing the costs of HVDC investment and does not model deadweight losses from increased electricity prices;
- the modelling does not include any scenarios where further HVDC investment is required even though this is a plausible scenario; and

[1] TPAG public briefing on transmission pricing discussion paper, Wellington, 29 June 2011, http://www.ea.govt.nz/about-us/news-events/events-calendar/tpag-public-briefing-on-transmission-pricing/

- modelling the generation that a central planner with perfect information would build, even with random but systematic variations to input parameters, does not provide much insight into generation investment decisions likely to be made by investors facing competition, information limitations and a range of uncertainties.

Furthermore, changing the HVDC charge now would demonstrate a poor commitment to maintaining regulatory consistency over time and this would have a detrimental impact on the investment confidence of generators and major users.

The test of "clear and material efficiency gain" should set a high hurdle for any proposal to change the transmission pricing methodology in a way that creates a clear wealth transfer from consumers to producers. Every cost allocation methodology has imperfections, so there should be a preference for stability and consistency over time. This is reinforced by the provisions in the Electricity Industry Code governing reviews of the transmission pricing methodology[2] and was recognised as a guiding principle in the transmission pricing project initiated by market participants in 2009. The final report of that project stated the following in its introduction:[3]

> The touchstone for any proposed options for reform should be the potential for *material improvement* upon the existing arrangements, ie, the enhancement of economic efficiency through altering the *commercial incentives* facing market participants and ultimately their decisions/conduct, so as to produce more desirable outcomes.
>
> Change for the sake of change is not an objective. In particular, options that simply alter the incidence of transmission changes (which is inevitable) to the financial advantage of one party or another, but do *not* give rise to any material improvement, will simply impose needless additional regulatory costs. Ultimately, reform will only deliver economic benefits if *desirable behavioural change* is brought about. A reform option must lead to real changes in the commercial behaviour/decisions of the relevant parties, in the manner intended.

2 Clause 12.86 sets out that the Authority may only review an approved transmission pricing methodology if it considers that there has been a material change in circumstances.

3 NERA Economic Consulting, "New Zealand Transmission Pricing Project: A Report for the New Zealand Electricity Industry Steering Group", page 1 (http://www.ea.govt.nz/document/6616/download/our-work/programmes/priority-projects/transmission-pricing-review/)

Connection "Depth"

Genesis Energy considers that there is not evidence that there would be a clear and material efficiency gain from changing to a deeper or shallower definition of connection assets. Given this, and given that any change would shift the incidence of costs and would inevitably create a new set of problems, we support retention of the status quo connection depth.

If you would like to discuss any of these matters further, please contact me on 04 495 3348.

Yours sincerely

RW Parry

Ross Parry
Regulatory Affairs Manager