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Submissions
c/- Electricity Authority
PO Box 10041
Wellington 6143

by email: submissions@ea.govt.nz

SUBMISSION ON TPM WORKING PAPER – LCE

1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the "Transmission pricing methodology: Use of LCE to offset transmission charges" working paper (the **paper**) released by the Electricity Authority (Authority) in January 2014.

Introduction

2 The paper indicates that the Authority will release a new issues and proposals document in the future, and we will reserve our position on that until we have the full picture. In addition a number of other working papers have already been produced and others are in preparation by the Authority. As such, our submission on this current paper is quite brief.

3 However, based on the working papers released so far, we are concerned that they lack coherence and are not well or clearly related to each other. The TPM has to work as a whole. An example specific to LCE is that the Authority has indicated (in the beneficiaries-pay working paper) that its revised proposal will involve an ex ante allocation of cost. Since LCE will have to be estimated more than a year in advance, and it is spectacularly volatile (swings of $100 million between years have occurred, and year on year changes of tens of millions of dollars are common)[1], where does the inevitable variance between forecast and actual go?

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[1] Admittedly before FTRs existed: for example there was an increase of $98 million in interconnection LCE between 2007 and 2008, which was followed by a reduction of $106 million between 2008 and 2009.

4 More generally, more than a year after the Authority received the first set of submissions on its TPM proposal, it has not responded clearly to the overwhelming key messages from submitters:

- There is no mandate for change (no material change in circumstances)
- The SPD beneficiaries-pays method does not derive meaningful private benefit estimates, is overly complex, difficult to understand, subject to both manipulation and lobbying and most importantly will not, in fact, lead to any net economic benefits from either better use of the transmission system or better future investment in it.

We think these points should be addressed first.

5 The Electricity Network Association (ENA) has also prepared a submission on the paper. Orion endorses the ENA submission.

Comments

6 LCE already offsets participants' costs, even if it is not directly linked to transmission costs, in all cases, by the time it gets to them. The question to be answered is whether there are better ways to do this, and in particular whether attempting to include this in the TPM is superior to the status quo. We are not convinced that it is, for the following reasons.

7 Nothing in the paper identifies efficiency improvements that will result from changing the way LCE is allocated compared with the status quo. Although we agree that the three options identified are all better than the original proposal, it is the status quo that they must improve on.

8 In the absence of efficiency improvements all we can see is somewhere between a not very different, and a significant reallocation of, LCE amongst participants, and to no good purpose wherever in the range it sits, without any obvious benefit.

9 The paper argues that offsetting transmission charges with LCE is a "market-based" approach under the Authority's decision-making and economic framework. We do not accept that the framework is helpful in an overall sense, but even within it the characterisation of LCE as "market-based" is questionable. LCE is generated by the *administrative* arrangements in the Code that set out how prices will be set and how participants will pay and be paid for energy, and how the excess from this process should be paid to Transpower by the Clearing Manager. Transpower then allocates LCE to its customers via an *administrative* process. The status quo and the various options under consideration are simply different administrative arrangements whose relative merits cannot be established by reference to the framework.

10 We caution against considering aspects such as spot price signals and gaming in isolation from other aspects of the wider TPM proposal: we note that whether participants will respond to the beneficiaries-pay elements of the proposal, and whether it might also lead to "gaming", cover very similar ground, but considering these in isolation prevents consideration of whether the effects are in the same direction or offsetting, or of their relative magnitudes. We also note that very similar discussions were had, and may be on-going, about the incentives created by the FTR market. In a similar vein the Authority itself published a paper last year setting out the incentive problems with a "pay as offered" approach to paying generators. This too needs to be in the mix. This overall perspective is touched on in section 7 of the paper, but to our mind it does not reach a conclusion.

11 As we pointed out in our March 2013 submission, for the connection assets that Orion is charged for, and apparently for many others across the country, Transpower calculates an LCE **debit**.[2] These amounts are somewhat counterintuitive, but as the total amount (for connection and interconnection combined) has always been a credit, which we pass on to retailers anyway, it has not caused us any concern. If in future distributors are only charged for connection assets, the LCE for us will not offset charges, but add to them. We would prefer it if this did not happen. We suggest that, whatever the LCE arrangements turn out to be, at the very least the method for calculating LCE for connection assets has a rule that any calculation that results in a debit be replaced with a zero value, with the remaining LCE reduced accordingly.

12 The components of Transpower's MAR are set out and defined in the Commerce Commission's individual price-quality path determination for Transpower. Does this permit the offsetting contemplated by the paper? We note for example that, as we understand it, while Transpower recovers its total revenue requirement in relation to its assets from its customers, its MAR is less than this total revenue. Yet LCE is being allocated across both regulated and unregulated revenue streams.

13 Transpower also currently carries out an annual wash-up which compares its actual regulated revenue with the MAR, and this alters its revenue requirement for the following year. This might create some odd inter-year effects when the notoriously volatile LCE is thrown into the mix? In general, we are not at all sure that the Authority has engaged adequately with Transpower and / or the Commerce Commission to develop an understanding of Transpower's regulatory regime sufficient to support a coherent TPM proposal.

[2] A debit for most connection assets and a credit for some, but overall a debit. This is in the context of interconnection **credits** that are much larger. We note that according to Table 4 in Appendix A of the paper, LCE associated with connection assets was an **overall debit** in 2005. Transpower has provided us with connection LCE data for the past 10 years which shows that for 57 of 160 GXPs/GIPs the connection LCE has been an overall credit (totalling $60m) while for the remaining 103 GXPs/GIPs LCE has been an overall debit (totalling $20m).

14 The reference in para 1.14 to “practical considerations” may be correct in relation to the options being considered in the paper (although we doubt that it is equally easy to calculate LCE irrespective of the granularity of assets over which the calculation is to be carried out), but they are not an issue with the status quo. Moreover, in the wider picture “practical considerations” can be enough to render inoperable some solutions that might otherwise be conceptually elegant. It would be better to uncover these sooner rather than later. Designing a TPM which Transpower cannot implement is in no one’s interest.

Concluding remarks

15 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Bruce Rogers (Pricing Manager), DDI 03 363 9870, email bruce.rogers@oriongroup.co.nz.

Yours sincerely

Bruce Rogers
Pricing Manager