Fonterra Co-operative Group

24 March 2014

Submission to the Electricity Authority regarding the working paper: “Transmission pricing methodology review: Beneficiaries-pay options”.

Overview

1. Fonterra Co-operative Group ("Fonterra") thanks the Electricity Authority ("EA") for the opportunity to make a submission in response to their working paper entitled "Transmission pricing methodology review: Beneficiaries-pay options" ("Working Paper").

2. Fonterra is the world's largest global milk processor and exporter of dairy products and is at the heart of the New Zealand dairy industry, and the dairy industry is at the heart of the New Zealand economy. Through our integrated "grass to glass" supply chain we deliver high quality dairy ingredients and a portfolio of respected consumer brands to customers and consumers in over 140 countries around the world.

3. Fonterra is owned by approximately 10,600 farmer shareholders who supply Fonterra with greater than 17 billion litres of milk each year that is processed across 28 processing sites in New Zealand. All of these sites, and the farmers that supply the sites, are reliant on an efficient, reliable, and secure electricity transmission and distribution grid.

4. In the 2013 annual report, Fonterra recorded a net profit after tax of $736 million, on revenue of $18.6 billion, and a cash payout of $6.16 for the 2013 year for a 100 percent share-backed farmer – comprising a Farmgate Milk Price of $5.84 per kgMS and a dividend of 32 cents per share.

5. Fonterra is a member of the Major Electricity User Group ("MEUG") and in principle, supports the more detailed submission lodged by MEUG, except where a different view is expressed in this submission on the Working Paper.

6. The Working Paper did not pose any specific questions; therefore this submission will note some general observations and feedback to the EA on the Working Paper.

Feedback on the Working Paper

7. Fonterra submitted in March 2013 to the EA's October 2012 consultation paper "Transmission Pricing Methodology: issues and proposal" ("2012 TPM proposal"). Fonterra has reviewed the subsequent transmission pricing methodology ("TPM") working papers the EA has issued (CBA[1], sunk costs[2], ACOT[3] and LCE[4]) and has submitted on each via MEUG.

8. As stated in our March 2013 submission to the EA's 2012 TPM proposal, "Fonterra views that the current TPM is working well, although acknowledge that it could be improved. Fonterra is generally supportive of the EA's review to explore how the TPM could be improved and encourages further exploration to ensure that if any improvement is implemented, that it is the correct solution and that it is implemented at the correct time."

9. This Working Paper assumes that a beneficiaries-pay option is the best approach for recovering the costs of HVDC and interconnection assets. In our March 2013 submission, we suggested that the EA consider other non-beneficiaries-pay options, and stated that "The proposal to use a beneficiaries-pay model requires further consideration...There are also many difficulties that arise from applying a beneficiaries-pay model to the electricity network as outlined in the [2012] TPM Proposal that are outlined further in this submission". Assessment of other options, such as exacerbators pay, has not been undertaken and instead the Working Paper focuses on various versions of a beneficiaries-pay option. It would be useful if the EA could consider these other options in greater detail before they are discounted.

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[1] Cost benefit analysis working paper, 3rd September 2013
[2] Sunk costs working paper, 8th October 2013
[3] Avoided cost of transmission working paper, 19th November 2013
[4] Loss and constraint excess working paper, 21st January 2014

10. It is difficult to comment on the specific options put forward in this Working Paper in isolation to the remainder of how the TPM will work, in particular how the residual charge will be treated. These two components need to be reviewed together in order to make an informed view of how it would work. Fonterra also notes that is difficult to determine if the options put forward in this Working Paper are in the long-term benefit of consumers as a detailed qualitative and quantitative cost-benefit analysis ("CBA") has not been undertaken. Fonterra looks forward to reviewing a robust CBA as part of the second TPM consultation paper due later this year.

11. However, there are several observations Fonterra would like to make regarding the current Working Paper:

    11.1. Fonterra welcomes the EA approach to link the Commerce Commission transmission investment decision making process with the transmission pricing methodology under the grid investment test ("GIT") options. As noted in our March 2013 submission, "The TPM Proposal must fit within the holistic regulatory regime, otherwise there will be unintended consequences or unrealised opportunities to maximise the benefits of altering the TPM." However, without further detail on the GIT based options and how the residual would be treated, we cannot comment if that succeeds or if there are unintended consequences or if it is the most appropriate option to be implemented.

    11.2. The inclusion of some demand response is a step in the right direction by the EA, but still may not adequately address it. As noted in our March 2013 submission, demand response was notably absent.

    11.3. The rationale behind the EA's proposal to include instantaneous reserve ("IR") providers as a beneficiary is unclear and we are uncertain if this is an appropriate proposal. IR providers assist with minimising the requirements for further transmission investments so it is hard to align this with them being a beneficiary of transmission assets.

    11.4. Fonterra notes that the beneficiaries-pay options that include a scheduling, pricing and dispatch ("SPD") charge component, that one of the parameters that the SPD charge has is that the "distributed generation would be calculated either on the basis of net or gross injection to the grid depending on which is most efficient". Fonterra does not support the SPD charge for distributed generation on the basis of gross injection; on the basis that this would incorrectly overstate the benefit that such distributed generation gains from the use of the HVDC and interconnection assets. Distributed generation, such as industrial co-generation plants, assists with alleviating the need for additional transmission assets as they are typically installed to meet the energy demands (both thermal and electrical) of a user, therefore eliminating or minimising the user's requirement to import electricity from the grid throughout the year. Refer also our March 2013 submission in paragraphs 30-31 where we raised several concerns regarding the treatment of embedded generation and these concerns remain.

12. Fonterra would also like to reiterate several positions put forward in our March 2013 submission on the 2012 TPM proposal as these views have not changed throughout the working paper series the EA has issued:

    12.1. [Paragraph 11] The current TPM Proposal would be improved if Pole 2 was not included as one of the assets in the SPD model. Pole 2 charges should remain with South Island Generators. There is no rationale for why Pole 2 should be treated as any different to any other connection asset with clearly identifiable beneficiaries.

    12.2. [Paragraph 13] A consumer's core business is typically not the electricity market; electricity enables them to conduct their business producing goods and services. Therefore consumers typically do not have the resources available to analyse and check the SPD modelling to ensure that they are being charged correctly. Also, the proposal is very complex and hard to predict what transmission charges a user will incur.

12.3. [Paragraph 37.1] There is an asymmetry of information to consumers...The EA needs to act on behalf of consumers, as per their statutory objective to "promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long term benefit of consumers".

12.4. [Paragraph 45] The TPM contains several elements that are not clearly defined regarding how they will work in practice. This ambiguity and uncertainty, combined with the potential wealth transfers that will occur, is likely to lead to further lobbying and legal action by some parties. The wealth transfer will potentially impact businesses decisions to invest in NZ or continue with their investments, which is not an efficient outcome for NZ.

12.5. [Paragraph 46] Fonterra is of the view that there is no need to rush through this critical complex process as the current TPM is not failing to any significant extent.

12.6. [Paragraph 47] Also, the implementation of any proposed TPM changes would benefit from being implemented using a transitional period, and this needs to be included as part of any implementation plan.

13. Fonterra supports the suggestion in the MEUG submission regarding extending the timeframe for consultation on the residual paper and the second TPM consultation paper, as well as holding several workshops to assist with understanding the proposal. The options put forward are complex and as stated in our March 2013 submission, a consumer's core business is not the electricity market, therefore the resources and expertise required to assess these papers are not readily available.

14. Fonterra also supports the view put forward in the MEUG submission that there are many solutions available to mitigate future inefficient capital investment by Transpower. Amending the TPM charges for interconnection and HVDC assets for prospective and perhaps existing assets, to an alternative approach, is worth exploring but it must show long-term benefits to consumers if it is to be adopted. Re-arranging the TPM leading to wealth transfers without evidence of long-term benefits, particularly in the treatment of existing assets, must be avoided.

15. Fonterra looks forward to commenting on the second TPM consultation paper due later this year.

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