Powerco Limited

CORPORATE OFFICE
84 Liardet Street
Private Bag 2061
New Plymouth
T 0800 769 372
F +64 6 758 6818
www.powerco.co.nz

22 September 2014

Submissions
Electricity Authority
PO Box 10041
WELLINGTON 6143

Dear Sir/Madam

Re: Transmission Pricing Methodology Review: LRMC charges

This is Powerco Limited's submission on the Electricity Authority's discussion paper *Transmission Pricing Methodology Review: LRMC charges*. Thank you for the opportunity to submit on this paper

We have seen and contributed to the submission made by the Electricity Networks Association (ENA) and agree with that submission.

We agree in principle that charges based on the long run marginal cost (LRMC) of new transmission investment have the potential to promote the Authority's statutory objectives and, consequently, that further investigation of LRMC-based charges may be warranted. As the Authority has noted in the discussion paper, such charges exist in some overseas jurisdictions, which means that the concept must be practicable, despite the Authority styling the approach difficult to implement in other parts of the document.

However, our in principle support is qualified by our view that the Authority should carefully review the work that has already been done in this area before launching a substantial new investigation. In 2009, NERA, on behalf of the New Zealand Electricity Industry Steering Group (known informally as "the CEOs' Group") investigated LRMC-based charging options and concluded that a tilted postage stamp charge that reflects the average LRMC of new investment over a long period of time would be a sensible approach that could be readily implemented[1][2].

The NERA report also considered the materiality of any changes to consumption and location choices that would be likely to flow from further adjustments to the allocation of transmission revenue and concluded that the practical impact of change would often be negligible. We urge the Authority also to give a high weighting to materiality when considering any possible future charging modifications.

[1] NERA, *New Zealand Transmission Pricing Project: A Report for the New Zealand Electricity Industry Steering Group*, 28 August 2009.

[2] It should also be noted that the current methodology contains a small tilted postage stamp element produced by the use of differential "n" values when calculating the interconnection charge, although it is acknowledged that this does not accurately reflect the LRMC of new investment.

We further suggest that the Authority carefully consider the wider pricing and investment arrangements that already affect transmission. Short term grid usage incentives are provided by nodal prices and major long-term investment is governed not by a market process but by a central planning process overseen by the Commerce Commission. It is possible that LRMC-based transmission charges might modify consumers' consumption and location decisions to make them more efficient; and that this could consequently affect the load growth forecasts used by Transpower and the Commission, and hence the need for further planned investment. However, as noted above, the influence of modifications to the allocation of transmission revenue on consumption and location decisions will often be negligible, so the materiality of any proposed changes will need to be carefully considered by the Authority.

When assessing the costs and benefits of any proposed changes the Authority should also consider carefully the degree to which the Commission is susceptible to lobbying to delay or bring forward major investments. The Authority's cost-benefit analysis of the SPD method was heavily dependent on this effect and, in our view, overstated it.

We would also like to reiterate the point that any change to the transmission revenue allocation method will create new opportunities for disputes over charging, which are inevitably costly from a national perspective. In our 2012 submission on the 2012 TPM proposal we described a number of areas where the SPD method would increase the scope for disputes[3], but the Authority made no meaningful response to these points. In our view, the Authority should pay more attention to the risk that changes will increase the scope for disputes and not dismiss it. One of the advantages of the current TPM is that, for the most part, it is well understood and accepted and, as a consequence of this , substantial disputes are relatively rare. As we have noted in previous submissions, the only part of the current TPM that is genuinely contentious is the HVDC charge.

Finally, we recommend that the Authority make no further use of its decision-making and economic framework. In our view, the Authority is increasingly using the framework for support rather than illumination and its application is becoming something of an analytical straightjacket rather than assisting the policy development process. In reality, so-called "beneficiaries pay" approaches may or may not be economically superior to "alternative" approaches and "exacerbator pays" approaches may or may not be superior to "beneficiaries pay" or "alternative" approaches. Whether or not this is the case needs to be demonstrated by individual cost-benefit analyses and not *a priori* assumptions.

If you wish to discuss any aspect of this submission please contact Ross Weenink (ross.weenink@powerco.co.nz), ph. (04)978-0522 in the first instance.

Yours sincerely

Richard Fletcher
General Manager Regulation and Government affairs

[3] Powerco, submission on *Transmission Pricing Methodology: Issues and Proposal*, 1 March 2013, p.14