24 March 2017

Electricity Authority
Via email: submissions@ea.govt.nz

Transmission Pricing Methodology: Second Issues Paper – supplementary consultation cross submission

The Electricity Authority Board is seeking feedback in cross submissions specifically on the valuation method for determining the total and annual amount to be recovered under the proposed area-of-benefit (AoB) charge for an investment. In the supplementary consultation paper, the Authority proposed that the valuation method would be the indexed historical cost or another method that was service-based and cost-reflective, if that would better promote its statutory objective.

Mercury is unclear why Electricity Authority is seeking feedback on such a narrow and specific topic rather than extending the timeframe for cross submissions and seeking feedback on more substantive points from submitters. Many submitters have in the past made requests for cross submissions, including Mercury, which have not been adopted by the Authority but now appears to be being used in a limited and, in our view, a least effective way.

Within the short two week timeframe for cross submissions we have found it challenging to meaningfully review the high number of submissions received by the Authority. None of the submissions Mercury has been able to review in the timeframe has lead us to shift our views from those expressed previously in the second issues paper consultation process to date.

We remain firmly of the view that the complexity of the current proposal outweighs its benefits. Many submissions raise concerns that the material impacts of the TPM are still highly uncertain given the lack of detail that will still need to be developed to implement the guidelines. This was raised as an issue of substantive concern for Transpower who stated: "We believe it is important that market participants understand that indicative prices may change significantly from final prices set under the new TPM"[1]. This is an area of on-going significant concern for Mercury and our customers as we continue to have little certainty as to the actual impacts from proposed reforms some four years on since the review was commenced.

From Mercury's perspective, the complexity we are currently seeing is a predictable outcome from the fact that the Authority's process is attempting to develop a TPM to addresses both historic issues and provide efficient signals for future investments. This is leading to highly challenging questions as to the extent of the historic assets to be included in the AoB charge as well as how the values of those assets should be determined. This is also resulting in very large and material swings in impact assessment for participants and we consider this is increasing the likelihood of future dispute and legal challenge.

The potential for unintended wholesale market impacts from the current proposed design features of the AoB charge is also of primary concern to Mercury. Transpower note that the potential for impact remains "untested and unquantified" particularly with the transition of charges for the HVDC from South Island generators to all generators. Mercury strongly agrees with Transpower that: "It may be inefficient to charge generators on the basis of average injection (clause 17(e)(ii)). Use of average injection would make the AoB charge part of the

[1] Transpower (Feb 2017) TPM 2nd issues paper, supplementary consultation pg 8

generators' SRMC (and flow through into offers and cleared prices)."[2]. This clearly has the potential to impact on consumer pricing and would be undesirable from a wholesale market efficiency perspective.

As stated in our previous submission, the Authority has accepted the logical of shifting away from generator charging for the residual for efficiency reasons. The inclusion therefore of the average injection clauses (both at 16(b)(ii) and 17(e)(ii)) should be removed.

In terms of specific feedback on using Indexed Historic Cost versus Depreciated Historic Cost as the valuation method for determining the AoB charge, Mercury has only been able in the time allocated to identify a small number of submissions that have addressed this issue and does not have a firm view on either application at this stage.

The concerns raised serve to clearly illustrate the challenges associated with changing retrospectively the treatment of historic sunk assets and the incentives it creates for dispute and legal challenge due to the large swings in impact assessment to individual parties. In our view, no matter how principled the arguments for change, the above dispute incentive is not easily reduced when it involves the significant reallocation of historic costs. For this reason we have previously advocated that prospective application of beneficiary pays is more likely to be accepted as the impacts will be lower, phased in over time and participants will be able to forecast these impacts in advance.

Please contact me on 09 580 3623 or nick.wilson@mercury.co.nz with any questions on the above.

Yours Sincerely,

Nick Wilson

Manager Regulatory and Government Affairs

[2] *Ibid*