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Submissions from Cape Reinga to Bluff demonstrate serious problems with the Electricity Authority's TPM plans

The Government's electricity reform package should be prioritised over any further transmission pricing work. The substantive problems with the 3rd Issues Paper and latest Cost Benefit Analysis (CBA) mean the Electricity Authority cannot legitimately progress the transmission pricing methodology (TPM) review, or make a decision by April 2020, without substantially delaying implementation of the Government reforms.

Summary of Entrust's views and observations

- **The Authority should prioritise Government electricity reforms over the TPM review:** Many stakeholders commented that the Authority should determine next steps on TPM after the Government announced its electricity reform package. The reform package includes a large work programme for the Authority focused on improving competition in the retail and wholesale electricity markets.

- **The expert reports on the CBA vindicate our assessment it can't be relied on:**[1] The Authority went ahead with the consultation on the 3rd Issues Paper despite external peer review identifying substantive problems with the CBA.

- **The Authority's claims about the benefits of its TPM plans aren't well founded:** There is clear rejection by most stakeholders and experts of the Authority's contentions about the benefits that could arise from its planned TPM changes. It is notable independent retailers, who don't have any "vested interest", are now engaging in the TPM process and have raised substantive concerns.

- **The Schedule 1 cost allocations are unsound:** Even though Rio Tinto is one of the parties that has most to gain financially from the Authority's TPM plans it raised serious and legitimate concerns in its submission.

  Rio Tinto's analysis confirmed our assessment that the Authority's modelling of consumer benefits from historic investments is wrong. While Rio Tinto focussed on allocation of the cost of the HVDC link their concern about overstating consumer benefits applies to other investments such as the benefits Vector gets from the North Island Grid Upgrade (NIGU).

Déjà vu with expert consultant reports confirming another failed CBA

The expert consultation reports confirmed our assessment that the CBA suffers from much the same problems as the previous two CBAs, which had to be replaced. It is troubling Axiom-farrierswier and Houston Kemp both assessed that the latest CBA is worse than the Oakley Greenwood CBA.[2] The significance of this is that the Authority had to replace the Oakley Greenwood CBA because of "computational flaws and weaknesses" and is now in the same situation with the latest CBA.

[1] Axiom-farrierswier, Houston Kemp, the Lantau Group and Professor Derek Bunn.

[2] Meridian and their consultant, NERA, were the only parties that endorsed the CBA, just as they endorsed the Oakley Greenwood CBA prior to it being abandoned. The Meridian-NERA review was superficial at best and heavily qualified.

The Axiom-farrierswier and Houston Kemp expert reviews identified most of the efficiency gains claimed in the Authority's CBA are actually wealth transfers ($2.3 billion),[3] and the CBA excluded nearly $2 billion of generation and distribution investment costs. The expert reports determined that once these issues and others are corrected the CBA becomes negative (between -$1.7 billion and -$2.3 billion, depending on how many of the errors are corrected).

None of this should come as any surprise to the Authority. The issues with the CBA were raised by external peer review and should have been resolved before the consultation went ahead.[4,5]

Unfortunately, we cannot take comfort from the wealth transfers in the CBA favouring consumers through lower wholesale electricity prices. The expert consultant reports confirm the Authority had relied on an implausible scenario in which removal of peak-usage charges results in increased peak-demand (predictably), but in ten years this somehow triggers a mass of generation investment despite the investment causing wholesale prices to reduce substantially.[6]

What would actually happen, as pointed out in various submissions, is that increased peak-demand caused by the Authority's plan to remove peak-usage charges would result in higher costs and prices. Any wealth transfers would be detrimental to consumers and the opposite of the Authority modelling.

The Authority got its assessment of the benefits of historic investments badly wrong

In addition to fatal CBA problems, serious issues have been identified with the proposed benefit-based charges for historic assets, despite the Authority working on the calculations for the last eight years. This should serve as a bellwether for the challenges and problems Transpower would face in attempting to implement the Authority's proposals.

The submission from Rio Tinto (Tiwai Smelter) confirmed our view that South Island consumers are not beneficiaries of the HVDC link.

The only reason the Authority determined Rio Tinto and other South Island load were beneficiaries was that it ignored the fact its own benefit assessment found South Island consumers incur disbenefits from the HVDC link. Rio Tinto may well be at the front of the queue to 'cut the cable' if the Authority goes ahead with its plans.

These results are not specific to Tiwai or the HVDC.[7] For example, according to the Authority's estimates, Vector receives disbenefits from NIGU at Lichfield of -$31,707 over the four-years so should not occur any charges for NIGU. However, the Authority instead plans to set its charges on the basis of $39,089 benefits over a two-year period. By way of example also, the Authority determined that Vector received disbenefits from Benmore-Haywards in one of the four years it modelled. The Authority's decision to exclude this artificially raised Vector's calculated benefits by over 11%.

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[3] In economic terms the Authority measured "consumer surplus" when it intended to measure "allocative efficiency" or dead-weight losses.
[4] The Authority delayed the consultation slightly to resolve some unspecified modelling issues.
[5] The external peer reviews, and even the fact peer reviews were sought, wasn't released as part of the TPM proposal material and, instead, was only released following Official Information Act (OIA) request. This reinforces our concerns about the transparency of the Authority's process.
[6] If increases in peak-demand resulted in lower wholesale prices this would suggest it would be desirable to subsidise peak-usage. This would turn economics on its head, but is what the Authority's CBA suggests.
[7] For example, Alpine Energy receives -$476,991 disbenefits from the HVDC at Tekapo A, but the Authority has deemed they receive $1,191,804 in benefits.

The Authority ignored its own definition of beneficiaries-pay and its proposed Guideline requirements in coming up with the Schedule 1 cost allocations.

Rio Tinto's comments that the "pricing proposals … contain serious flaws and inconsistencies", the Authority has used "Speculation … for setting charges", "the Authority did not have the requisite skill … This casts serious doubt over the credibility of the modelling" and about the the "risk" of creating "the impression the Authority was solving for a pre-determined, and undisclosed, outcome" should be of particular concern for the Authority given Rio Tinto is supposed to be one of the main supporters of the Authority's TPM plans.

The last three years have been a missed opportunity

If the Authority had paid heed to the transmission pricing submissions it has received over the last several years it would have given genuine consideration to moderate reform options, that avoid large negative wealth transfers and price shocks, and could act as the 'circuit breaker' needed for the Authority to complete the TPM review.

Unfortunately, the Authority did not spend the last three years addressing the legitimate and genuine concerns raised by submitters. What is evident from the 2019 submissions is the commonality with submissions made in 2016, in response to the 2nd Issues Paper, and even in 2012, in response to the 1st Issues Paper. The problem the Authority is now in is that it would not be credible to continue to issue new consultation papers and new CBAs, but the Authority lacks any credible basis for its planned TPM changes.

Concluding remarks

In our submission, we suggested the best way forward would be to either cease the TPM review, at least until the results of the Electricity Price Review had come out,[8] or look at moderate reform options that would not involve large wealth transfers and price shocks.

The Government's electricity reforms provide the Authority with an opportunity to pause on TPM. The Authority's priority must now be to implement the Government's reform package and help remedy the competition problems in the retail and wholesale electricity markets. The Government, for example, announced a ban on winbacks.[9] Our submission noted that resolving the two-tier market/saves and winbacks issue could make consumers, particularly vulnerable and low-income consumers, better off by up to $500 million per annum. This would dwarf any possible TPM reform benefits.

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Kind Regards

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Chairman

[8] The Authority put on hold decisions on saves and winbacks pending the outcome of the Electricity Price Review and appeared to have done the same with other matters such as hedge market development.
[9] And also related restrictions on use of exiting customer data.