2 March 2020

Submissions
Electricity Authority
Level 7, Harbour Tower
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By email: tpm@ea.govt.nz

To the Electricity Authority

Meridian submission on TPM: 2019 issues paper:

Supplementary consultation

1. Meridian Energy Ltd welcomes the opportunity to submit on the Electricity Authority's supplementary consultation paper dated 11 February 2020.

2. Meridian **supports** the Authority's four proposed refinements to the 2019 issues paper. We set out our reasons in the submission below, followed by a summary of our responses to the six specific questions asked by the Authority in the Appendix attached to this submission.

Refinement 1: DHC method for new investments

3. The Authority proposes that annual benefit-based charges for post-2019 grid investments be set according to the depreciated historical cost (**DHC**) method, instead of the indexed historical cost (**IHC**) method proposed in the 2019 issues paper.

4. Meridian supports this refinement and the use of DHC for post-2019 grid investments as we have submitted previously.[1] The use of IHC would be inconsistent with the approach of the Commerce Commission to asset valuation, and so the TPM would be less consistent with clause 12.89(1)(a) of the Code.[2] It would misalign revenue recovery rules under the Commerce Act with the cost allocation method under the TPM. This would require residual charges to be adjusted over the life of the asset, which will cause increasing difficulty as the residual charge reduces over time. Upgrades of assets would cause additional difficulties. The Authority's refinement avoids all these problems associated with the IHC approach.

5. We agree with the Authority that the match between beneficiaries and costs is likely to be better in the early years, when a DHC-based charge would be higher. Putting this around the other way, the consequences of a mismatch in the later years of an investment are minimised under a DHC-based approach where the charges would be lower.

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[1] See Meridian Energy *Submission: Transmission Pricing Review: 2019 Issues Paper* (1 October 2019) at pp 20-21.

[2] Clause 12.89(1)(a) requires Transpower to develop its proposed TPM consistent with any determination made under Part 4 of the Commerce Act 1986.

6. We have previously explained why DHC is the only appropriate methodology for valuing existing assets, including through NERA's analysis that switching to the IHC approach part way through the life of an asset could lead to over-recovery.[3] The Authority's proposed refinement would mean the same approach would apply to both existing and post-2019 assets. This will allow the new TPM to operate more efficiently.

7. We further agree that the Guidelines should require Transpower to use DHC, rather than allowing Transpower to propose an alternative method. The case for the efficiency benefits of using DHC has been made, with ample time for submitters to propose any alternatives.

Refinement 2: Charges upon plant closure

8. The Authority proposes that if a direct connect or generation customer closes down one of its plants, its liability for associated benefit-based charges would cease ten years after the commissioning of the relevant grid investments, instead of continuing indefinitely as was proposed in the 2019 issues paper.

9. Meridian supports this refinement. It is consistent with our general view that a durable TPM should contain a benefit-based charge which is adaptable,[4] and NERA's analysis that overall an element of predictable review to the benefit-based charge "should make the TPM more durable."[5]

10. The proposed refinement will better achieve those aims. It will ensure that the new TPM is adaptable to major changes (i.e. plant closure), rather than benefit-based charges under the TPM potentially discouraging customers from closing a plant where that would be efficient. The effect of the refinement will be that benefit-based charges will continue, in future years, to allocate the cost of the investment between users and over time in proportion to the benefits that grid users are expected to get from the investment.[6]

11. Any period of years since the date of commissioning would have efficiency benefits as it would make the TPM more adaptable without potentially encouraging inefficient behaviour. However, we support the Authority's pragmatic selection of a 10 year-period. We also support measuring from date of commission, on pragmatic grounds, as it provides a mechanistic way for customers to apply this proposed refinement.

Refinement 3: Annual lagged updates to residual charge

12. The Authority proposes that the initial allocation of the residual charge is adjusted annually based on changes in the four-year rolling average of gross annual energy usage, lagged by seven years. There was no prescribed regular adjustment process for the residual charge under the 2019 issues paper.

13. Meridian supports this refinement. The Authority correctly points out the benefits of regular and mechanistic review of charges, and the risk that, without a mechanism for regular review, customers' decision-making could become distorted.[7] The proposal will promote a new TPM which is adaptable and therefore remains durable in the long term. We support the detailed components of this refinement as each will make regular and mechanistic review possible.

14. Meridian would go further in supporting the updating of benefit-based charges as well as the residual, as we have previously outlined in submissions to the Authority.[8]

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[3] See Meridian Energy *Submission: Transmission Pricing Review: 2019 Issues Paper* (1 October 2019) at pp 17-18; Meridian Energy *Submission: Transmission Pricing Methodology: Supplementary 'Refinements' Consultation* (24 February 2017) at paras 35-69; and see NERA *Transmission pricing methodology – review of supplementary paper* (24 February 2017) at section 3.2; and NERA *Review of Electricity Authority's transmission pricing review 2019 papers* (1 October 2019) at section 4.4.

[4] Meridian Energy *Submission: Transmission Pricing Review: 2019 Issues Paper* (1 October 2019) at p 22.

[5] NERA *Review of Electricity Authority's transmission pricing review 2019 papers* (1 October 2019) at para 31.

[6] This is one of several principles elaborated upon by the Authority in the 2019 issues paper: Electricity Authority *2019 issues paper: transmission pricing review: consultation paper* (23 July 2019) at para D.65.

[7] Electricity Authority *Transmission pricing methodology: 2019 issues paper: supplementary consultation* (11 February 2020) at para 5.13.

[8] See Meridian Energy *Submission: Transmission Pricing Review: 2019 Issues Paper* (1 October 2019) at pp 20-21; Meridian Energy *Submission: Transmission Pricing Methodology: Issues and proposal: Second issues paper* (26 July 2016) at section 20.7. For example, we do not agree with the Authority's observation in

Refinement 4: Expanded PDP

15. The Authority proposes that a customer may apply for a prudent discount if its transmission charges would exceed the standalone cost of the transmission services it receives. This basis for a prudent discount was not included as part of the prudent discount policy in the 2019 issues paper, although a similar proposal was introduced in 2016.[9]

16. We supported the very similar proposal in 2016 on the ground that a customer facing charges above standalone cost has an incentive to disconnect from the grid and build its own transmission assets or alternatives, and that in most cases this would increase transmission charges for other grid users. This would be an inefficient outcome.[10] NERA's analysis at the time was that the prudent discount policy was "unambiguously efficient".[11]

17. We support this refinement because it does not substantially alter the balance struck by the Authority's 2019 issues paper; and also for the reasons advanced by the Authority, us, and NERA in 2016; and overall because the refinement is consistent with the general desirability of having a meaningful prudent discount policy as part of the TPM.

Implementation

18. As the Authority recognises, changes to the wording of the draft Guidelines will need to be made in order to implement the proposed refinements.[12] We do not consider that those amendments require any further consultation on the Guidelines before they are put to Transpower, because the intent and nature of the refinements is clearly articulated in the Authority's supplementary consultation paper.

19. Finally, Meridian agrees that there are "significant flaws in the current TPM"[13] and we continue to encourage the Authority to implement its proposed TPM reform as an urgent priority, so that the substantial efficiency and durability benefits of the proposed new TPM can begin to be realised as soon as possible.

For any questions relating to this submission, please contact Jason Woolley or Sam Fleming.

Yours sincerely

Jason Woolley
Head of Regulatory Affairs and Corporate Legal

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footnote 7 of the supplementary consultation paper that "Revising the allocation of the benefit-based charge regularly would distort incentives to properly scrutinise grid investment proposals and to reveal information to the Commerce Commission during the investment approval process."

9 Electricity Authority *Transmission pricing methodology: issues and proposal: second issues* paper (17 May 2016) at para 7.227(e).

10 Meridian Energy *Submission: Transmission Pricing Methodology: Issues and proposal: Second issues paper* (26 July 2016) at section 22.5.

11 NERA *Transmission pricing methodology – review of second issues paper* (26 July 2016) at section 7.1.

12 Electricity Authority *Transmission pricing methodology: 2019 issues paper: supplementary consultation* (11 February 2020) at para 7.1.

13 Electricity Authority *Transmission pricing methodology: 2019 issues paper: supplementary consultation* (11 February 2020) at para 2.4.

Appendix

Responses to specific questions

Question	**Answer**	**Submission reference**
Q1. Should the annual benefit-based charges that recover the costs of post-2019 investments be set using DHC, IHC or some other approach?	DHC.	See submission on refinement 1 above.
Q2. Should Transpower be required to use the DHC as proposed, or should it be able to propose a different method if that better met the Authority's statutory objective?	Transpower should be required to use DHC.	See submission on refinement 1 above.
Q3. If a transmission customer closes one of its plants, should its liability for associated benefit-based charges continue indefinitely, cease immediately or cease after a specified period of time has elapsed since the commissioning dates of the relevant grid investments? If the latter, should that period by 5, 10 or 20 years? Should the relevant period be expressed relative to the commissioning date of the investment or some other period?	After a specified time, 10 years, from date of commissioning.	See submission on refinement 2 above.
Q4. Should the guidelines stipulate for regular updates to the residual charge allocation?	Yes.	See submission on refinement 3 above.
Q5. If so, is the revised proposal an appropriate way to provide for such updates?	Yes.	See submission on refinement 3 above.
Q6. Should a load customer be eligible for a prudent discount if it can establish that its transmission charges exceed the efficient greenfield standalone cost of supply?	Yes.	See submission on refinement 4 above.