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Submissions
Electricity Authority
Wellington

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Allocation of LCE should be to consumers and not generators, and should preserve the integrity of nodal pricing

Electric Kiwi, Flick Electric, Haast Energy Trading (Haast), Pulse and Vocus (the independents) welcome the Electricity Authority's request for cross-submissions on the matter of loss and constraint excess (LCE) allocation. Inclusion of cross-submissions should be standard regulatory practice, particularly for any topic that is likely to be contentious.

It is clear from submissions that most of the submitters support: (i) allocating LCE to WEM purchasers (Option D) (our preferred option) or, (ii) if a TPM-based allocation approach is adopted, allocating based on the residual charge (our 2nd preferred option). We note the high level of support for allocation using the residual charge despite this option not being included in the SRAM consultation paper.

It is also clear from submissions that there is little support for allocating LCE to generators. The independents support allocation to consumers only.

LCE allocation should be considered in light of the wholesale market review

We agree with Electric Kiwi and Haast, LCE allocation has more to do with the efficient operation of the wholesale electricity market than network pricing. Similarly, we agree with Transpower that "Transpower as grid owner should have no role in the allocation process for amounts arising in the WEM" and "there is no need for settlement residue to be allocated using a TPM-based method".

We also agree with Entrust "The Authority proposal would add an additional $30m to generators on top of the $850m per annum of over-pricing the Authority found was caused by the arrangements Meridian and Contact have with Tiwai" and "The Authority should rule out policy which would exacerbate market power problems with additional windfalls and wealth transfers".

Submissions provide no justification or support for allocation of LCE to generators

It is clear generators should not be allocated any LCE.

We agree with Genesis "to the extent that settlement residue is not being returned to spot market purchasers of electricity, they are paying more for the use of and access to the grid than it costs to provide".[1] We also agree with Meridian an option the Authority should consider is to "codify a

[1] Meridian similarly agreed with the Authority statement that: "wholesale purchasers of electricity (retailers and industrial consumers) are effectively overpaying for their energy purchases and do not receive any benefit from settlement residual rebates."

standardised allocation method that … allocates settlement residual to wholesale purchasers rather than transmission customers".

It is surprising none of the incumbent gentailer/ERANZ member submissions offered support for the Authority's preferred option B as this would result in a $30m per annum (based on 2020/21) wealth transfers from consumers to generators (principally ERANZ membership).[2] We note that:

- The only submissions in support of options involving allocation to generators were Contact, Genesis and Mercury and Network Tasman (who all supported Option A which is essentially the status quo).

- No submitter supported the Authority's preferred option B,[3] and only Contact supported option C (as a "fall back" option to their preferred Option A).

- We agree with Flick: "Generator offers and offer behaviour (creating price separation) clearly … impact the value of the wholesale market settlement surplus residue. Flick strongly disagrees with a methodology (particularly the Simple BB approach) which results in a significant increase in residue revenue payable to generators (~$30 million per year increase or 52% of total residue payments according to Figure 2) when they clearly have control over the level/value of the residue".

- We agree with Transpower that "If the Authority chooses option B, it will be important for the Authority to satisfy itself these wealth transfers are justified by material efficiency improvements. The same is true for any SRAM option that would result in significant wealth transfers" and "It could harm the durability of the new TPM if wealth transfers arising from SRAM changes harm consumers and/or exceed efficiency benefits".

FTRs

We agree with Electric Kiwi and Haast "Issuing more FTRs and residue products against the LCE can make SRAM more predictable and uncorrelated with spot outcomes (consistent with the consultation paper's principle 1). This could keep the price signals consumers and generators see net of SRAM close to efficient levels and increase wholesale market liquidity via increased opportunities for risk repackaging".

There is widespread support for the principle that efficient WEM price signals should be preserved net of SRAM. This principle is undermined if SRAM is materially composed of spot market-based LCE as opposed to auction revenue. The Authority should prioritise maximising the auctioning of LCE via the FTR Manager to deliver on this principle.

Concluding remarks

It is apparent submitters preferred the Authority's earlier thinking in its previous half-dozen consultations on LCE allocation, which focussed on the importance of preserving the integrity of nodal pricing, and recognised allocation to generators could distort generator behaviour, as their offer strategy could be aimed at increasing their LCE share.

The independents recommend the Authority put aside the "early thinking" in the current SRAM consultation and, as advocated by Electric Kiwi and Haast, only consider options which adhere to the

[2] Meridian said option B was better than option A.
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“two fundamental principles: that “the allocation method should: (i) address that LCE arises because “consumers pay more for electricity than generators receive”; and, consistent with principle 1 in the consultation paper, (ii) preserve the integrity of WEM nodal pricing”. This was also a focus of Flick’s submission.

Acknowledgement that LCE arises from “consumers [paying] more for electricity than generators receive” and therefore should be allocated to consumers was a recurring theme in submissions, and not just the submissions by independent retailers.

Yours sincerely,

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