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Proposal to amend the Electricity Industry Participation Code 2010

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This form is to propose:

☐ An amendment to an existing clause in the Electricity Industry Participation Code 2010; or
☒ A new clause in the Electricity Industry Participation Code 2010.

Please complete as many sections of this form as possible and email or fax it to the above number/email address. The more information you include in your proposal, the faster your proposal will be able to be assessed/progressed.

Proposer's details

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Signature:	
Date:	01/04/19

The proposal / preferred option

Suggested proposal name (please keep it short)	Allocation of (Residual) Loss and Constraint Excess Payments Code Amendment
State the objective of your proposal.	To ensure the economically efficient return of AC Loss and Constraint Excess Payments (LCE) to Retailers thereby promoting economic efficiency and competition which is in the long-term benefit of consumers. Locational marginal pricing in the wholesale market means that retailers and direct connect purchasers overpay relative to what generators are paid by the Clearing Manager, giving rise to a surplus in the form of LCE. Current arrangements in the industry ensure that a proportionate share of AC interconnection LCE is rebated to direct connects but not necessarily retailers.[1] Retailers, by and large, undertake wholesale market risk on behalf of their customers and yet are not guaranteed an AC interconnection LCE rebate.

[1] The same concern applies to AC connection LCE but the issue is most material in terms of AC interconnection LCE. For example, in calendar year 2016, some $40m in AC interconnection LCE was collected across the wholesale market. The share paid to distributors was roughly $36m, of which some $18m would not have been passed on to retailers by distributors based on current practices (AC connection LCE in contrast totalled only $6m in 2016.

Does the proposal relate to an existing Code clause? If yes, please state the full clause reference.	No. Although the Code prescribes that LCE should be passed to Transpower (See Appendix), there is no regulatory regime for dealing with their return to retailers. The Code is not specific about how Transpower should allocate the LCE it receives. Transpower's own policy[2] on the allocation of LCE mirrors transmission pricing. Distributors and direct connects, who pay AC interconnection transmission charges, are rebated AC interconnection LCE on a proportionate basis (South Island generators, who pay HVDC charges, are rebated HVDC LCE on a proportionate basis too.) Retailers are therefore reliant on distributors redistributing LCE to them, and not electing to retain them.
Describe the specific amendment(s) that you propose be made to the Code *OR* attach a draft of the proposed Code amendment (optional). Note the Code drafting manual provides guidance on drafting.	a) Require Transpower to allocate LCE to customers in accordance with its prevailing methodology:- - LCE for the HVDC asset class: to customers that pay HVDC charges in proportion to each customer's contribution to total HVDC charges; - LCE for the AC interconnection asset class: to customers that pay AC interconnection charges, in proportion to each customer's contribution to total AC interconnection charges; - LCE for each AC connection asset: to customers that pay AC connection charges on a given connection asset, in proportion to each customer's contribution to connection charges on that asset. b) Require distributors in respect of LCE for AC (connection and) interconnection assets to pass through that LCE to retailers in proportion to their allocation of network charges to those retailers.

[2] https://www.transpower.co.nz/sites/default/files/uncontrolled_docs/Loss%20and%20Constraint%20Excess%20Booklet.pdf

Identify how your proposal would support the Authority's objective, as set out in section 15 of the Electricity Industry Act 2010 (Act)[i], specifically addressing the competition, reliability and efficiency dimensions of the objective.	Under the current regime, Transpower receives payments from the wholesale market Clearing Manager and pays them on to its transmission customers (which include EDBs) as per Transpower Policy. However, there is no regulatory framework ensuring that these payments to EDBs are then paid to retailers. Some EDBs pass on LCE to retailers on their networks, others do not. This is a concern as there is a lack of transparency and consistency which produces economically inefficient outcomes and negatively impacts on competition. It is also relevant to bear in mind that retailers are the ones who have overpaid in the wholesale market and should therefore entitled to the LCE, not the EDBs. The attached economic report from Sapere outlines the net efficiency gains from the proposal compared with the status quo and other alternatives (also see other options below). There are also benefits to competition from the proposal as the allocation of LCE to retailers can provide improved risk management for retailers during high events driven by constraints and retail cost-to-serve may be reduced or consumers can benefit from improved/additional market offerings. There is no consistency among EDBs in the allocation of LCEs and there is a lack of transparency in what happens to LCE that are retained by EDBs. EDBs may be boosting their unregulated revenue by retaining LCE or using the funds for investment opportunities that have no bearing on electricity consumers. The Commerce Commission has confirmed that LCE are outside their ambit under Part 4 of the Commerce Act because, ironically, LCE arises from wholesale market activity and has nothing to do with distributors providing line function services.
Which of the purposes listed in section 32(1) of the Act does your proposal most closely relate to?	**Efficiency:** We refer to the Sapere analysis which concludes that our proposed code change is the only scenario (c.f. alternative options below) that preserves efficient infra-marginal prices, and hence promotes dynamic efficiency. **Competition:** allocation of LCE to retailers can provide improved risk management for retailers during high events driven by constraints and retail cost-to-serve may be reduced or consumers can benefit from improved/additional market offerings.
Identify whether you consider your proposed change to be urgent, providing supporting rationale.	We consider the issue should be a priority to be resolved as soon as possible in 2019 and could be progressed separately to any further work on the TPM review.

Please set out the expected costs and benefits of your proposal. These should include your assessment of the direct cost to develop and implement the proposed Code amendment, and the consequential costs and benefits as a result of the amendments, to all affected parties.	There is nil cost borne by the Authority except those associated with a code change. As some EDBs are currently returning rebates on a proportionate basis, it is an easily achievable practice with some administrative effort required. There are long term efficiency benefits with Mercury's proposal of $398m NPV compared to retaining the status quo at $199m NPV). The Mercury proposal is also the only scenario that preserves efficient infra-marginal prices, and hence promotes dynamic efficiency. Refer to the Sapere analysis.
Who is likely to be substantially affected by this proposal?	Retailers, some EDBs and consumers.
Identify whether you consider (providing supporting rationale): (i) your proposed change to be technical and non-controversial; or (ii) there is widespread support for your proposed change among the people likely to be affected; or (iii) there has been adequate prior consultation so that all relevant views have been considered.	(i) We consider the proposed change technical and non-controversial. This is because LCE payments arise largely from overpayment by retailers in the wholesale market. Some EDBs already rebate LCEs to retailers. For those that don't, the change would be a simple administrative one. (ii) There is broad in principle support from a range of retailers and potentially end users but the proposal would need further consultation at the industry level. (iii) The issue is not new and the EA has previously consulted on the allocation of LCE as part of its TPM review.
Why this is your proposed option?	It is the most effective and economically efficient solution in the long-term interests of consumers, ensures transparency and the correct allocation of rebates to the impacted parties.
Any other relevant information you would like the Authority to consider.	The proposed amendment also aligns with the Commerce Commission's continued program of increased disclosure and transparency of revenues associated with distribution company activities.

Assessment of alternative options

Please list and describe any alternative means of achieving the objective you have described for your proposal. For each alternative, please provide the information in the table below (i.e. repeat this table below for each alternative). The list of alternatives should include both regulatory (i.e. Code amendments) and non-regulatory options (e.g. education, information, voluntary compliance). If you have a preferred option please identify it and explain why it is your preferred option.

Brief description of an alternative means of achieving the objective. Note if this is your preferred option.	**Alternative Option A** The Code could require the Clearing Manager or Transpower to allocate LCE directly to wholesale purchasers. This would however, be a major Code change and be far more complicated to implement. Transpower's Benchmark Agreement would also need to be amended in these instances as well as Transpower's existing methodology. **Alternative Option B** The Code could be amended to require the EDBs to return the LCE directly to end consumers. This option however does not preserve efficient infra-marginal prices nor promote dynamic efficiency. **Alternative Option C** Another alternative is to net-off HVDC and interconnection LCE from Transpower's HVDC and interconnection revenue requirements respectively. The approach effectively would take the option to retain LCE out of the equation entirely for EDBs and reduce transmission charges passed through to retailers by EDBs. Other affected parties, such as direct connect users and HVDC customers of Transpower would expect to be left in much the same financial position as the status quo due to reductions in interconnection and HVDC rates offsetting their lost LCE rebates. However, this option would not preserve efficient infra-marginal prices.
The extent to which the objective of your proposal would be promoted or achieved by this option.	These Alternatives would achieve an efficient LCE regime and better promote competition by reducing the cost-to-serve. However, the proposed solution is preferred over these alternatives. Alternative A would require a methodology to allocate payments to retailers and would have to ensure that direct connects are not made better/worse off. It would have higher implementation costs and would be a more complicated code change requiring changes to the Transpower Benchmark Agreement. Alternative B and C: We refer to the Sapere analysis which concludes that neither option would preserve efficient infra-marginal prices nor promote dynamic efficiency. They also would produce no benefits to retail competition.
Who is likely to be substantially affected by this option?	Retailers, EDBs, Transpower

The expected costs and benefits of this option, including direct costs to develop it, and consequential costs and benefits to all affected parties.	Please refer to the Sapere analysis setting out the benefits of the proposal. Costs are minimal and administrative.

[i] Section 15: Objective of Authority

The objective of the Authority is to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers.

APPENDIX

Clauses in Code relating to LCE

Clause 14.35: Each grid owner [Transpower] must treat residual loss and constraint excess paid to it under this Part as loss and constraint excess.

Clause 14.16: Calculation of loss and constraint excess
(7) Unless the Authority has directed otherwise under this clause, the amount owing to each grid owner in the proportions advised under subclause (6) is –

(b) the amount of any residual loss and constraint excess.

Clause 14.16(6): The Authority must advise the Clearing Manager of the proportion of loss and constraint excess owing to each grid owner.

Clause 14.20: Amounts owing by Clearing Manager to participant
(2) The Clearing Manager must specify any amount owing by the Clearing Manger to the participant in respect of the periods referred to in subclause (1) for the following:
(k) loss and constraint excess and residual loss and constraint excess under clause 14.16(7).