MAJOR ELECTRICITY USERS' GROUP

24 September 2010

Lisa DuFall
Electricity Commission
By email to submissions@electricitycommission.govt.nz

Dear Lisa

Submission on Transmission Pricing Review Stage 2 Options paper

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Electricity Commission (EC) consultation paper "Transmission Pricing Review (TPR): Stage 2 Options" published 27th July 2010[1]. MEUG appreciates the EC having extended the consultation period. This has allowed us to better manage parallel consultation by the Commerce Commission on implementing Part 4 of the Commerce Act.

2. Before responding to the questions in the consultation paper, MEUG notes Transpower representatives at the EC Regulatory Managers' Meeting on 16th September observed there was unlikely to be sufficient time to change the Transmission Guidelines and then implement changes for the transmission pricing year starting 1st April 2012. There would seem to be no point in pursing an intensive work programme to proceed to stage 3 if there is no chance of making changes to prices effective 1st April 2012. A pause now to allow other changes to the market to be bedded in including the Commerce Commission evolving inherited Part F responsibilities (eg implementing a new GIT), would seem prudent.

3. MEUG response to the questions in the consultation paper follow:

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Q1. What, if any, bearing do you consider the Authority's proposed objective has on the review's approach to analysis and evaluation to date?	There will be important differences in the governance environment after the Electricity Industry Bill is enacted compared to the status quo as follows: • The Commerce Commission will develop a new GIT that will need to be consistent with the purpose of Part 4 of the Commerce Act; and

[1] Refer http://www.electricitycommission.govt.nz/consultation/tprstage2options/view

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	• The Electricity Authority will have more focus on competition and efficiency. Collectively these changes will lead to better regulatory frameworks to ensure only investments, either reliability or economic, that have a positive NPV and promote the long-term benefit of consumers will be approved.
Q2. Do you agree that the Commission has identified the relevant factors in its assessment (paragraphs 3.2.6 to 3.2.13) of whether nodal pricing provides adequate signals for efficient generation and load investment? If not, please explain your reasons?	Agree nodal prices, in the current NZ market, may not match perfect pricing signals because the nodal price fails to reach the Value of Un-served Energy (paragraph 3.2.7). There is a risk of post-transmission investment muting of pricing signals (paragraph 3.2.8) but over the long run as the market evolves so energy prices better reflect costs, then that risk is likely to reduce. Once the Electricity Industry Bill is enacted the risk of imprudent investment being approved (the third factor in paragraph 3.2.9) should be significantly reduced as noted in response to Q1.
Q3. Do you agree with the Commission's approach (outlined in paragraphs 3.2.21 and 3.2.22) to determining whether any form of additional locational signal through transmission pricing is necessary? If not, please provide reasons.	The consultation paper proposes modelling between perfectly co-optimised investment and a base case or counterfactual assuming no locational signal. MEUG suggest the counterfactual should be the status quo, which does have locational price signals. The correct analysis is therefore to assess the incremental costs and benefits of further enhancing locational price signals against the status quo, not an abstract "no locational signals" scenario. The consultation paper reports results from using GEM to implement the Commission's approach. GEM provides useful information for comparing broad trends such as those in the SOO, but may be of limited use where more precision from say a stochastic model is needed. The submission by Norske Skog Tasman sets out a full critique of the usefulness of GEM as a tool for this analysis.
Q4. Do you agree that there appears to be limited value in providing an enhanced locational signal to generators to ensure co-optimisation of economic transmission investments and generation? If not, please explain your reasons.	Analysis in Appendix 3 seems reasonable, as an upper bound, for the effect of locational signalling through interconnection costs, but see response to Q3.

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Q5. Do you agree that it needs to be determined whether the current locational signal provided by the HVDC charge is causing or is likely to cause inefficient operational and investment decisions? If not, please explain your reasons.	Reviewing HVDC aggregate charges, pricing methodology and service levels to ensure they are fit-for-purpose compared to alternatives is the more important question. Locational price signals are just one element to be considered within such a review.
Q6. Do you agree with the high-level analysis provided on the costs and benefits of the current HVDC charging regime? If not, please explain your reasons.	Table 1 of the consultation paper contains the high-level analysis and table 2 summarises the initial assessment. Taking each benefit and cost, and grouped where useful, MEUG note: • The benefits listed in (a) and (b) overlook the "demonstration effect" from not charging for an investment, once made. Not charging the beneficiaries of investments will distort signals for future investments; creates incentive to call for investments that beneficiaries do not value sufficiently to be willing to pay for, because they know that they will not have to pay for them. • The benefits listed in (a) and (b) do not consider the dynamic efficiency effects from investment incentives to South Island users/consumers, who would otherwise invest in North Island, overseas or not at all. • Given the inevitable uncertainty in costing various future generation options in different parts of the country, the estimated costs of (c) are so small that it is not certain whether the incentive of the HVDC charge in relation to NI generation is actually a cost. It could be a benefit if measurement errors were excluded. • Preliminary view that cost (d) is not material appears reasonable. • Agree that there is some disincentive with cost (e), but there are also positive effects. Builders of plant in the South Island who are focused on meeting local demand and not interested in providing power to the North Island still benefit from the link through higher prices in the South Island than there would be without the link, but they also have to pay a share of the costs of the link, even though they are not major beneficiaries. The positive incentive would likely outweigh the negative. Builders of South Island peaking plant pay a

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	share of the cost of the link even if they never use it, although they also benefit from higher prices in the South Island than there would be without the link. That peaking plant would generate only when prices were high anyway. Overall there is likely to be a net benefit rather than net cost. • Further investigation is needed of whether suggested cost (f) is reflected in how South Island generators actually make investment decisions. In other words we are doubtful if this is in practice an impediment to competition to build new generation in the South Island. The anecdotal evidence is that, apart from Meridian, there are several existing and new investors in generation that have been progressing possible projects.
Q7. Do you agree that the Commission has correctly identified the four possible options for the HVDC charge? If not, please explain your reasons and provide alternative options.	The four options in figure 2 summarise the 4 broad categories that should be considered further.
Q8. What are your views on the validity of each of the options?	Cannot state a view without undertaking a cost-benefit-analysis. Note MEUG comments on shortcomings of the analysis of the existing regime in Q6 above.
Q9. Do you have specific lower-level issues around the structure and details of HVDC charging that you would like considered in stage 3?	No.
Q10. Do you agree with the analysis provided in the section headed "Analysis of benefits of signalling reliability-driven investment"? In particular do you agree with the conclusion that any incentive through the TPM which defers future reliability-driven transmission investment will likely provide some net benefit? If not, please explain your reasons.	Disagree, consider it unclear and missing the point that this additional signalling will not be required in future under the new decision-making arrangements discussed in response to Q1, which will prevent approval of reliability investments that do not provide positive net benefits. Requiring beneficiaries of an investment to pay for that investment would provide them with incentives to choose the option that provides the highest net benefits, which may in some cases be a transmission alternative.
Q11. The Commission has decided not to pursue the options outlined in paragraph 4.1.8. Do you agree with the	MEUG agrees with the proposal not to further pursue the high level options of augmented nodal pricing and market-wide tilted postage stamp.

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Commission's assessment (including the analysis contained in section 5 of Appendix 2) that these options are not worth pursuing? If not, please explain your reasons.	The 'but for' approach cannot be the same as the PJM approach because NZ does not have a capacity market that is an integral part of the PJM 'but for'. Appendix 2 of the consultation paper discusses this and also refers to work by Castalia for Transpower on issues with the PJM 'but for' approach. MEUG believes the EC needs to consider the 'but for' approach more innovatively as it might be applied to an all energy market. Indeed the 'but for' approach looks very similar to a one-off load flow analysis that the Commission has considered worthy of further investigation. The capacity rights and arbitrageur options for the HVDC are more complicated than the status quo as the consultation paper notes. However they would have additional advantages in automatically addressing the South Island peaking plant investment disincentive problem outlined in response to Q6 (cost (e)) above and allowing flexibility to allocate charges to users even if, over time, north to south flows become more frequent.
Q12. If the Commerce Commission proposal outlined in paragraph 4.2.16(c) is adopted for the final determination, do you think this will address the regulatory anomaly referred to above?	Yes, MEUG agrees allowing non-exempt Electricity Distribution Businesses to retain avoided transmission charges where it can be demonstrated this will be in the long-term benefit of consumers and the share of benefits (that is between the lines businesses and consumers) matches that likely in markets with workable competition.
Q13. The Commission has identified three options alongside the status quo to defer or avoid reliability transmission investments. Do you agree that these options are worth pursuing? Are there other options which deserve further consideration? Please provide reasons.	We do not think these are necessary, if adopt the first best solution, which is to invest in only those of the proposed reliability investments that provide positive net benefits and to have beneficiaries pay for these investments.
Q14. Can you suggest other matters to be included in the Commission's stage 3 deliberations on charging for HVDC costs?	Three other matters need to be considered: • Dynamic efficiency effects on South Island consumer/user investment incentives (also noted in response to Q6); • The risk of a demonstration effect, whereby it creates incentive for beneficiaries to call for investments that they do not value sufficiently

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	to be willing to pay for, because they know that they will not have to pay for them (also noted in response to Q6); and • Incentives for the HVDC operator to uncover and meet the service levels desired by those that pay for the HVDC and to lower costs (or the rate in cost increases) for any given service level.
Q15. Do you agree with these preliminary conclusions? If not, please provide reasons.	MEUG agrees with the preliminary views of the EC that there are options (eg based on MWh usage) that could result in better outcomes compared to the current HAMI based cost allocator for HVDC costs. We emphasise this is only a preliminary view and more detailed analysis is needed. Paragraph 4.3.3 (a) states "there is little or no economic benefit in encouraging North Island generation through an HVDC charge on South Island generators (it will not result in a significant decrease in transmission costs)." This statement is consistent with the analysis in table 1 as summarised in table 2 that we have responded to in Q6 above, ie we believe the assessment is inadequate in that it fails to consider other benefits. These are also listed in response to Q14 above.
Q16. Do you agree that connecting parties should be able to negotiate mutually-beneficial access arrangements for independently provided new connection assets? If not, please explain your reasons, giving specific examples where possible.	Agree subject to the Commerce Commission and Electricity Authority monitoring outcomes and being prepared to consider intervention if unintended barriers or anti-competitive behaviour emerge. In other words a light-handed approach should be the first step.
Q17. The Commission has developed three options that it considers have potential to encourage efficient investment in static reactive power. Which of these options do you consider best encourages this objective? Please give reasons.	No comment, other than that we have doubts about the options, given that static reactive power cannot be transmitted very far, so can result in local monopolies, which are difficult to address through market solutions.
Q18. Are there other options for the allocation of static reactive power costs that the Commission should pursue?	No comment.

4. This submission is not confidential.

Yours sincerely

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Executive Director