Orion

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Submissions
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SUBMISSION ON TPM SECOND ISSUES PAPER – SUPPLEMENTARY CONSULTATION

Introduction

1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the "Transmission Pricing Methodology: Second issues paper – Supplementary consultation" (the **paper**) released by the Electricity Authority (Authority) in December 2016.

2 In summary:

- We are pleased that the Authority has reviewed its previously proposed changes to prudent discounts.
- While we agree that the guidelines should be less prescriptive, this does make it even more difficult to assess whether any benefit is likely to accrue from the changes.
- We agree that the guidelines should be more principles-based and less prescriptive. However, the greater flexibility given to Transpower, when combined with the principles and other elements of the proposed guidelines, may make it very difficult or impossible for Transpower to design a 'compliant' TPM.
- We remain unconvinced that the proposed changes will be beneficial or materially better than the status quo.
- We continue to believe that the potential removal of some sort of peak pricing signal will place at risk long established demand response and that this could in turn, inefficiently, bring forward grid investment.
- We are concerned about an apparent lack of consistency between the Authority's TPM proposals and its approach to distribution pricing.

3 The remainder of our submission is in two parts:

- General comments on the paper.
- Specific comments on the draft guidelines.

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General comments

Regulatory approach

4 The paper focusses on "refinements" to its previous proposals. We comment on some of them in more detail below, but in addition to refinements we would have expected more detailed and fundamental response to previous submissions. In the absence of that discussion we reiterate points that we do not believe the paper adequately addresses. For example:

- We are still unsure how the proposed changes will improve grid investment decision-making. As we and other distributors have said throughout, the way transmission is priced does not much affect the way we think about or comment on proposed new (interconnection) grid investments.

- There are still no examples given of past bad grid investment decisions, and nor has the Authority explained how its concern about this squares with its own analysis showing material net benefits from all major recent grid investments.

- There is still no discussion of why the major capex IM under Part 4 of the Commerce Act (as it applies to Transpower) is not a relevant area for consideration if bad decisions have been and presumably are still being made.

5 In our view, good regulatory practice and robust consultation involve a response to points raised and explanation of why particular points have been agreed with or disagreed with.

Area of benefit

6 With the flexibility to be given to Transpower around calculating AoB charges it is less clear what impact they will have. However, we can say that we have more clarity as to how the Authority conceives of them.

- AoB is only an **allocation mechanism** which is related back to allocating a given cost (see for example para 26(f) of the Executive Summary). Thus it is quite possible that charges will exceed benefits, but it is highly unlikely that a party that benefits very significantly from an investment will pay more than the cost, despite being willing to. This seems some way from the conception of SPD beneficiaries-pay back in October 2012 (although we acknowledge that even then there was the concept of capping).

- The expected impact on LCE is to be included in the AoB calculation, which strongly implies it will be an "effect on the spot market" calculation. This may well be a good way to assess transmission investment desirability, but as distributors are not spot market participants, these effects are very indirect and arguably non-existent for us. Many distributors are also poorly placed to see and understand the modelled effects, or to challenge them. Since there is unlikely to be any necessary relationship between overall benefit and overall charges it might be better to focus just on the use and the cost.

- To the extent that changes in LCE are held to be important, we note that, even though distributors currently receive a share of these, we generally pass them on to retailers. But if we did not, more directly linking charges to LCE may, on the paper's conception of how we participate in these decisions, incentivise distributors to oppose efficient grid investments because we would lose out on LCE allocation, while being indifferent to spot price effects.

- Regarding the concern about large customers shifting supplier (paras 65 to 68 of the Executive Summary), we note that a large customer not currently directly connected to the grid does not (or will not) have any AoB or residual charges allocated to it. So were the customer, in future, to choose to connect directly these charges would need to be retrospectively calculated. However this calculation is done, it may nevertheless be the case that those charges are different to the transmission component of prices that a distributor might have been charging it. We therefore do not see how charges can "shift with it".

The residual

7 While we support a more principles-based approach to the guidelines, we believe Transpower may struggle to devise a TPM that complies with all of them. For example (from para 64 of the Executive Summary):

- The first requirement is that "…the quantum of residual charge that load is charged cannot change…" is partly true by definition, at least in aggregate – Transpower's total revenue is determined separately and we presume the AoB component will be quite stable which makes the residual stable also.

- However, the next requirement is that the charge be "…related to the size of the customer's load, so that the allocation of charges is durable". Durability implies, to us, that the relationship between charges and load is preserved over time, which suggest that charges will change over time, for example as the relative shares of load change. This seems to contradict the first requirement.

- The requirement to credit back DG that offsets load seems to contradict the principle that charges reflect load, at least in any actual sense. Charges will inevitably reflect something more than load if this requirement is met.

- The requirement that Transpower "…use load to determine the customers that must pay…and the extent to which they must pay" looks to repeat the requirement about being related to load so it is perhaps unnecessary. In any case it has the same issues.

- The requirement to "correct for double-counting and other anomalies" is easy to write but perhaps much more difficult to achieve. In pointing out these problems we suspect submitters intended to indicate that the proposed method was fundamentally flawed rather than just in need of a few tweaks. That was certainly our intention, and it remains our view.

- The requirement that the method result in "broadly equivalent charges [for] broadly equivalent circumstances" is an interesting one and one that may not align well with the others. However, it looks to be very open to interpretation.

8 Separately, and as explained in previous submissions, the preference (but not the requirement) for using anytime maximum demand (AMD) to allocate cost between loads almost inevitably creates a breach of the equivalence principle. In our view shares of coincident maximum demand remains a much superior method than AMD, both in general, and in terms of the proposed principles. It is clearly more service-based.

9 Overall we see a risk that the guidelines are so open to interpretation that either:

- Any detailed TPM (including the existing one) could comply with them, or
- There are many iterations as Transpower seeks to pin down what is actually meant, which it may not succeed in doing.

10 We are also unsure if much consideration was given to using or more closely aligning the principles in the TPM guidelines with the distribution pricing principles. It is unclear why they would not be closely aligned.

Peak pricing signals

11 We remain concerned that the proposed changes will significantly weaken the price signals for peak period demand response. We disagree with the Authority's view that such response is inefficient, and we believe that the existing transmission system capacity reflects that response. Weakening the signal could therefore bring forward grid investment, and it is hard to see how this could be efficient.

12 We acknowledge that the draft guidelines allow for an LRMC component with any new TPM. However the discussion in the paper on LRMC seems to set a high bar for Transpower to clear. It also places an even stronger emphasis than earlier TPM papers did on the role of nodal prices in providing peak pricing signals. As well as the point that distributors, and currently most consumers, are not exposed to nodal prices, we do not believe that as grid owner Transpower can prudently solely or even primarily rely on nodal price signals to manage grid investment.

Alignment with distribution pricing developments

13 Some aspects of the proposed TPM seem to run counter to the work the Authority has been doing on distribution pricing, and this may make it difficult for distributors to design their pricing in ways that support the TPM objectives.

14 Specifically, the TPM guidelines state:

> *…to the extent that it can be economically achieved, [the TPM should] be designed such that a customer's residual charge will not change as a result of the customer's actions or the actions of another party other than Transpower, such that it does not create incentives or opportunities for designated transmission customers to inefficiently avoid the residual charge.* [1]

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[1] See Appendix E – Proposed guidelines - to the latest TPM consultation paper, clause 32 (d).

15 Oakley Greenwood, for the Authority, put it another way in their further comments on the TPM cost benefit analysis:

> *For such reduction or loss in allocative efficiency to occur implies that distribution businesses would structure their tariffs so that their now fixed transmission costs are recovered from customers via a variable charge. Our view is that pricing in this way would be inconsistent with economic theory. This also may make little commercial sense, if it exposes that business to volumetric risk (because its marginal prices differ to its marginal costs). In short, the outcome "conceived" is not a direct function of the wealth transfer per se, but rather a function of the (inefficient) tariff structures that are assumed to be adopted by the distribution business in response to that wealth transfer.*[2]

16 This is somewhat at odds with the guidance the Authority has issued on how it will assess compliance with the low fixed charge regulations. The guidelines state: "A capacity charge that varies according to the amount of electricity a consumer expects to consume is a variable charge."[3]

17 It appears that, for the proposed new TPM to work, and for a key component of its cost-benefit case to be positive, distributors must be able to price in a way that regulation prohibits, at least for most residential customers.

Comments on the proposed guidelines

18 Our comments in this section should not be construed as support for the approach outlined in the paper.

19 Clause 27 (b): Should it be "cost-reflective" rather than "cost-effective"?

20 Clause 33: Sub clauses (a) and (b) together appear to have the effect of requiring no more than that "the method" must be "a method". This does not seem to be much of a requirement. There do not seem to be any cross references to this clause. It would be better in our view to place all the relevant design principles for the residual charge in clause 32 and not have clause 33 at all.

21 Clause 35: What are "the [AOB] charges and residual charges attributable to [a] large consumer" that is not currently connected to the grid but becomes a direct consumer (under clause 34 (b)? We believe such charges are not defined in advance.

22 Clause 55: This might be better expressed as "…taxes) of all of the consumers supplied, directly or indirectly, from the distributor's network in the 2019/20 …". This avoids possible confusion about who the distributor's "customers" are, and it also makes it clear that there can be consumers supplied from secondary networks.

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[2] See Appendix B – Responses to issues raised on CBA - to the latest TPM consultation paper, p 37.

[3] See "Variable charges under the low fixed charge Regulations: Guidelines", at http://www.ea.govt.nz/dmsdocument/21123, para 2.18, p7. The Authority does not seem to have made Oakley Greenwood aware that these regulations exist.

23 The Electricity Networks Association (ENA) has also submitted on the paper. Orion endorses the ENA submission.

Concluding remarks

24 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Bruce Rogers (Pricing Manager), DDI 03 363 9870, email bruce.rogers@oriongroup.co.nz.

Yours sincerely

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