Entrust
Majority shareholder of Vector

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The Authority is focussing on the wrong pricing issues

There are clear and substantial problems with the Electricity Authority's transmission pricing methodology (TPM) proposals that need to be addressed before the review is progressed further.

The Authority's proposals require far more than the four "refinements" contained in the most recent consultation paper.

Entrust is worried the Authority is suffering from "go fever",[1] and placing completion of the TPM review ahead of addressing the long list of serious issues with the proposals identified over the last seven years.

Summary of Entrust's views

- **The fundamental problems with the Authority's proposals and CBA mean, alternative, moderate reforms options should be considered or the review should be cancelled altogether**. The Authority is in the same position, following the third Issues Paper, it found itself in after the first and second Issues Papers. A few second-order tweaks and "refinements" to the proposals will make little difference.

- **The Authority, for example, has not resolved the serious problems with the methodology** it intends to impose for calculating the benefit-based charges for historic investments. The issues identified with the Authority's planned HVDC re-allocation, for example, are far more serious than the four "refinements" the Authority is consulting on.

- **The revised asset recovery profile and stand-alone cost price cap proposals address corporate interests** including Meridian and Rio Tinto, in particular. The Authority has given little consideration to views raised by those representing consumer interests.

- **The latest set of proposed "refinements" are a continuation of the Authority's u-turns:** The Authority previously advocated using Depreciated Historic Cost (DHC) for asset valuation, then changed to Indexed Historic Cost (IHC), and has now reverted to DHC. The Authority proposed a stand-alone cost price cap in 2016, then removed it, without explanation, from its last set of proposals in 2019 and has now reintroduced the proposal.

- **The Authority's proposals don't comply with its own "beneficiaries-pay" principle:** It is difficult to see why the Authority would prefer use of a DHC recovery profile as the charges would be highest when benefits are lowest and vice versa.[2]

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[1] https://en.m.wikipedia.org/wiki/Go_fever

[2] The Authority has similar objections to the current RCPD charges.

The Authority should resolve the long-term harm its proposals would cause for consumers

The Authority's priority should be to consider whether to continue to pursue its TPM proposals. This could render the current consultation moot.

The submissions in response to the 2019 Issues Paper, as well as the Authority's own external CBA peer review, raised substantive questions about the Authority's proposals. Even Meridian's advisors suggested the Authority had overstated the benefits of its proposals by 90%.

There is clear, reasonable and objective evidence that:

- the latest CBA is unsound and should not be relied on;
- the Authority's proposals would be harmful to consumers, the economy and the environment;
- there are substantial workability and practicability issues with implementing and applying the Authority's proposals; and
- the proposals would violate the Authority's own "beneficiaries-pay" principle that no consumer should pay more than they benefit.

Entrust questions the choice of the four issues the Authority is consulting on

There is a very long list of issues the Authority needs to address. We have not been able to make sense of the topics the Authority choose for further consultation.

The revised asset valuation and stand-alone cost price cap proposals appear to be targeted at addressing corporate interests, rather than consumer welfare concerns. This does not fit well with the Authority's strategic vision to be "consumer-centric" or the Authority's "recogni[tion] consumers need to be at the heart of our decision making":

- **The stand-alone price cap would result in wealth transfers between different transmission customers:** A key difference between the existing Prudent Discount Payment (PDP) arrangments and the proposed stand-alone cost price cap, is the existing PDP arrangements are intended to keep transmission charges lower than otherwise for other customers. The stand-alone cost price cap would simply result in wealth transfers between different transmission customers.
- **The DHC cost recovery methodology is inconsistent with beneficiaries-pay:** The Authority's reasoning for preferring DHC appears to be incoherent. Transmission customers would pay the most for benefit-based investments when the benefits are lowest, and would pay the least when they benefit the most.[3] This is the opposite of what would be expected if the charges were set on the basis of the benefits transmission customers get from Transpower's investments.
- **The Authority has not demonstrated Anytime Maximum Demand (AMD) is the best allocator for the Residual Charges:** A number of substantive issues have been raised with use of AMD. These should be addressed before the Authority considers refinements to how AMD would be applied.

[3] What would happen if the transmission investment was to enable new renewable generation in a particular region but most of the generation investment wasn't expected until after the grid investment was made?

The latest set of proposals are a continuation of the Authority's design reversals

The Authority has made several policy u-turns that have not been explained.

For example, the Authority considered a virtue of its initial TPM proposals was that the benefit-based charges would vary half-hour by half-hour. Now the Authority wants transmission charges to be as fixed as possible with limited provisions for changes in allocation.

The Authority previously considered LRMC pricing was more efficient than relying on nodal pricing, but now considers that nodal pricing provides sufficient peak-usage signals and LRMC is not needed or even desirable.

The Authority previously advocated using DHC for asset valuation, then changed to IHC and now back to DHC. The Authority proposed a stand-alone cost price cap, then removed it from its last set of proposals and has now reintroduced the proposal.

If the Authority introduces benefit-based charges it should ensure they don't violate its own "beneficiaries-pay" principle

The Authority's Decision-making and Economic Framework (DMEF) defines "beneficiaries pay" as: "A beneficiary is a party for whom the private benefits of the investment exceed its share of the costs and who would therefore be willing to pay for a portion of the investment if that were the only means of acquiring the benefit". A clear requirement of this principle is that transmission customers don't pay more than they benefit from a grid investment, and don't pay for grid investments they don't benefit from or use.

The Authority's proposal to introduce benefit-based charges would violate its own beneficiaries-pay principle and result in charges that don't reflect the benefits transmission customers receive e.g.:

- Submissions in response to the 2019 Issues Paper overwhelmingly highlighted the way the Authority proposes to 'lock-in' calculation of the benefit-based charges would mean, over-time, the charges would become further and further removed from the actual benefits transmission customers receive.

- The allocation of historic investments is biased against consumers. It does not appear the Authority has dealt with the substantive concerns about its proposed vectorised Scheduling, Pricing and Dispatch (vSPD) method for determining who benefits from historic investments. Vector, for example, detailed some of the ways "the proposed SPD method overstates consumer surpluses and understate producer surpluses".

- Rio Tinto's analysis confirmed our assessment that the Authority's modelling of consumer benefits from historic investments is wrong. The Authority's own benefit calculations show that Rio Tinto, and other South Island load, don't benefit from the HVDC, yet the Authority is proposing to charge them for it anyway. While Rio Tinto focussed on allocation of the cost of the HVDC link their concern about overstating consumer benefits applies to other investments such as the benefits to Vector from the North Island Grid Upgrade (NIGU).

Wealth transfers between suppliers and consumers are not a zero-sum game

The Authority has undertaken that it will review its interpretation of its statutory objective and acknowledged "In the process of collecting material to inform our strategy to date, we have received widespread feedback, both internal and external, that our interpretation would benefit from a review".

Entrust welcomes this commitment.

The Authority's interpretation is wrong. The Authority should apply the same interpretation as the Commerce Commission, under both the Commerce and Telecommunications Acts.

Consumers benefit both from efficiency improvements, to the extent they are shared by suppliers with consumers, and from pricing improvements (wealth transfers). This is consistent with the comments from one of the Authority's advisors – that consumers benefit from price reductions even if there are no efficiency benefits – in response to the observation that the latest TPM CBA includes wealth transfers:[4]

> If all prices fell by $10 then people could e.g. (a) work less and enjoy the same consumption benefits (b) save and invest in somethingwithout foregoing any of their consumption benefits (c) buy more of something else touse/consume. So even if they have zero elasticity in the market in question there is stillscope for a substantial welfare improvement - depending on why the price changed.

It isn't clear how the strategic review of the interpretation of the statutory objective will fit with the TPM review. If the Authority accepts its interpretation is wrong it will have fundamental implications for the TPM review and the Authority would not be able to adopt its proposals:

- The Authority should reject any TPM proposal that results in consumers paying more, and generators paying less;
- The current allocation of the HVDC to South Island generators should be retained, and neither South Island nor North Island consumers should pay for the HVDC;
- The Authority should reconsider whether the residual charge should be paid solely by consumers; and
- The Authority should consider alternative transmission pricing methodologies, such as Vector's proposals, which target charging generators for transport of electricity and not just connection and HVDC.

Concluding remarks

Entrust is deeply concerned fundamental problems with the Authority's TPM proposals are not being addressed. The Authority is prioritising its desire to introduce new TPM rules over the long-term interests of consumers.

The Authority should address concerns such as that its proposals would result in higher peak demand bringing forward transmission investments and higher spot prices, and the benefit-based charges won't reflect the actual benefits consumers receive from transmission investments.

Entrust reiterates "the best way forward would be to either cease the TPM review … or look at moderate reform options that would not involve large wealth transfers and price shocks".

We also reiterate "The Government's electricity reform package should be prioritised over any further transmission pricing work". The work needed to complete the TPM

[4] E-mail From: John Stephenson [mailto:john@sense.partners], To: Tim Sparks Cc: Jean-Pierre de Raad, Subject: Re: FW: Wealth transfers in the TPM CBA, Sent: Thursday, 21 March 2019 10:41 AM.

review could not be progressed without substantially delaying implementation of the Government reforms.

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Kind Regards

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