

27 SEPTEMBER 2022: SUBMISSION TO ELECTRICITY AUTHORITY REGARDING SETTLEMENT RESIDUE ALLOCATION

Lines companies best placed to ensure Loss Rental Rebates are paid to consumers

Entrust has reviewed and reiterates its view that passing Loss Rental Rebates (LRR)¹ directly to end-consumers is the only guaranteed way to ensure consumers receive 100% of the benefit of the rentals including our Trust beneficiaries but also to other Auckland consumers.

In September this year, 351,000 households and businesses received an annual Entrust dividend of \$273 dividend plus an extra \$30 LRR payment from Vector. Together these injected over \$100 million into the Auckland economy. Importantly they arrived intact, largely into consumers' bank accounts.

The Entrust dividend is significant to consumers. As New Zealand's largest dividend payout, consumers have benefited from over \$2 billion paid out since 1994.

Each year, Entrust asks consumers to choose whether to receive payments directly into bank accounts or as a credit to their power accounts. The vast, vast majority opt for cash.

Times are tough in the current inflationary climate, the LRR payment made directly to consumers is in line with the choice consumers make, and they need the money now. We think it belongs to them.

Executive summary

- **The Authority should focus on ensuring transparent LRR pass-through to consumers**, rather than regulation of how pass-through is done.
- **The Authority should make it clear that pass-through needs to occur via direct payment to end-consumers and/or retailers.** This would minimise the compliance costs for lines companies that already pass on LRR.
- The Authority has expressed a "view" that LRR should be passed through via retailers but has not provided any explanation why it would be undesirable for lines companies to directly pass LRR to consumers or would not be to the long-term benefit of consumers.
- We aren't arguing against pass-through via retailers being an option for lines companies but the LRR requirements should recognise it is consumer-money.
- **LRR should not be allocated to generators.** The LRR is an "excess" arising from load customers paying more than needed to fully compensate generators under nodal

¹ The Authority has used various terms for LRR with the latest being "settlement residue".

pricing. We do not support any LRR allocation or increase to generators. Using language from the Authority's inefficient price discrimination (Tiwai) consultation, we consider the Authority's proposal would result in "inappropriate wealth transfers".

- The Authority should also consider the extent to which the load profile of residential consumers may impact the extent to which they contribute to LRRs relative to other consumers and transmission customers.
- LRR allocation does not need to be tied to the transmission pricing methodology (TPM). **There was no support for the Authority's preferred simple Benefit-Based (BB) method in the last consultation.**
- We reiterate that if a TPM approach is adopted, **the residual charge should be used as the allocator**² and would be most consistent with the Authority's TPM decisions. This option has received substantial support in the settlement residue allocation methodology (SRAM) and earlier loss and constraint excess (LCE) consultations. This included support from all the gentailers in earlier consultations.
- Entrust is conscious **Kiwis are struggling with the fallout from COVID19 on incomes and stressed budgets, and can ill afford a loss of LRR**, including the potential \$19m annual wealth transfer to generators.

Entrust's submission

The Authority should be agnostic about whether pass-through is via direct payment to end-consumers and/or retailers

Entrust remains of the view that the Authority should focus on ensuring LRR is returned to end-consumers in a transparent manner.

The discussion in Chapter 5 of the consultation paper provides a basis for requiring lines companies to pass-through LRR but does not provide valid grounds for the Authority's view that lines companies "should pass their rebates through to their retail, direct generation, and direct load customers" only.

The Authority has instead jumped from the observation that "Distributors currently vary as to whether and how they pass rebates through to customers, owners, or trust beneficiaries" to the "view ... that distributors should pass their rebates through to their retail, direct generation, and direct load customers".

The chapter is otherwise clear what is needed is that "transmission users (generators, industrial consumers, and retailers or their customers) receive the settlement residual rebates" [emphasis added]. The chapter also makes clear if there isn't pass-through it "could mean that end users collectively may be paying more in total than Transpower's costs for transmission services" [emphasis added].

Even if the Authority is correct that it is unlikely retailers will be able to retain LRR "as a windfall gain" it does not justify precluding lines companies from passing LRR directly through to end-consumers.

The Authority received submissions that it should consider the extent to which different options would result in pass-through to consumers. This would help confirm that LRR should be ALL allocated to load and the Authority should not prohibit consumers directly receiving LRR from lines companies.

² If the Authority uses a TPM benefit-based method it should allocate to load-only based on their relative benefits.

The Authority's work on the extent to which network price reductions in 2020 were passed through appears to still be outstanding, but could help inform this matter.^{3,4}

<p>Increasing retail price change transparency</p>	<p>Review how the network price changes that took effect on 1 April 2020 passed through into the retail electricity market.</p>	<p>Publish NZIER Cost Index Published on EMI in early 2021 Publish The Retailer Survey externally in April 2021</p>	<p>Target partially achieved, project continuing in 2021/22 The Cost Index has been drafted and we are working through the publishing process, with the process due to be completed by the end of August 2021.</p>
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Proposed clause 12A.3 should focus on transparency of pass-through rather than prescribing an allocation method

The proposed purpose (clause 12A.3(1)) that settlement residue is allocated "to consumers (or retailers on behalf of consumers)" is appropriate. The current Vector-Entrust LRR arrangements are consistent with this purpose.

The remainder of the draft Code change appears to conflict with the purpose. Instead of referring to paying LRR "to consumers (or retailers on behalf of consumers)" the remainder of the draft Code refers to "customers".

The Authority's response to submissions does not provide sound basis for departing from the majority view that LRR should be allocated to load

Entrust welcomes that the Authority has engaged in response to submissions. However, we do not consider the Authority responses provide a sound basis for rejecting the views of most submitters who supported allocation to load only and/or allocation using the residual:

- **Generators should not receive LRR:** Entrust agrees with the Authority that LRRs arise because "Downstream nodal prices are generally higher than upstream nodal prices, due to transmission losses and congestion" and "These price differences mean consumers pay more for electricity than generators receive" i.e. LRR arises due to over-payment by consumers under nodal pricing. There is nothing in the Authority's consultation which counters the point that we and other submitters made that "Electricity generators are already fully compensated for the electricity they generate".
- **The SRAM proposal acts as a substitute for removal of exacerbator pays in the current TPM:** The Authority has rejected our submission that "The LRR allocation proposal appears to be intended to try to fix issues with the proposed new TPM, including the absence of an "exacerbator-pays" or congestion charge" by making statements that confirm what we said: "in line with BBC allocations ... exhibit desirable exacerbator pays features by shielding parties from congestion and upgrade costs".
- **Allocation using the residual is most consistent with the TPM Guidelines and new TPM:** Entrust considers the Authority is incorrect that "Using the residual charge as the SRAM allocator ... does not achieve coherence between BBCs, transport charges and rebates". The opposite is true. We reiterate we agree with the Authority's previous view that using the residual charge as the allocator would minimise distortions to wholesale market and TPM price signals.⁵

³ <https://www.ea.govt.nz/assets/dms-assets/28/Electricity-Authority-Work-Programme-Report-for-the-12-month-period-to-30-June-2021.pdf>

⁴ The Electricity Authority has reviewed how the price change communication guidelines are working but has not looked at "how the network price changes that took effect on 1 April passed through into the retail electricity market" i.e. the extent to which network price reductions were reflected in lower retail prices.

⁵ Electricity Authority, Transmission pricing methodology: Use of LCE to offset transmission charges Working paper 21 January 2014.

- **The Authority has not addressed its previous views on LRR allocation or why those views have changed so radically.**
- **Giving LRR to generators would exacerbate the spot market over-pricing** the Authority has identified in its wholesale market review **and result in substantial windfall gains to generators:** Based on Authority calculations its proposal would result in reduction of LRR allocated to load from approximately 80% to 60% or a detrimental \$19m wealth transfer from load to generators.

While the Authority claims that “This only appears to be the case if SRAM is considered in isolation from the TPM” the decision on SRAM/LRR allocation is separate from TPM decisions. The Authority has already decided to introduce a new TPM which results in large wealth transfers from consumers to South Island generators. The proposed SRAM/LRR allocation method will result in additional wealth transfers from consumers to generators.

Allocation of LRR via the residual (Maximum Allowable Revenue) received widespread support

While the Authority’s now preferred simple Benefit-Based method received no support in the previous consultation, there was a high degree of support for allocation using the residual. This included previous support from all the incumbent gentailers.⁶ We consider that the earlier LCE working paper consultation provides a sounder basis for considering the issue of LRR allocation than the more recent SRAM consultations:

- Contact: “We agree with the preferred approach of option 2 –classifying LCE by asset class and applying LCE originating from connection assets against charges for individual assets with the remaining LCE credited against the Transpower’s maximum allowable revenue in bulk.”
- Genesis: “Genesis Energy supports option one that proposes to credit LCE against the maximum allowable revenue (MAR) in bulk. This is the option we advocated for as part of the straw-man for a revised TPM proposal.

“We consider that this option reduces the volatility of the TPM charge, is simpler than offsetting against individual assets, and addresses the concern that offsetting LCE against specific assets will negate the efficient wholesale market signals.”

- Mercury: “We support option 2 which is the option favoured by the Electricity Authority. Option 2 involves classifying LCE by asset class and applying LCE originating from connection assets against charges for individual assets. Under this option, the remaining LCE would be credited against the maximum allowable revenue (MAR) in bulk.

“... some parties may have both the incentive and the ability to inefficiently “game” the spot market to alter the creation and allocation of LCE in order to reduce their transmission charges. This may be at the expense of other participants. Crediting remaining LCE against the remainder of the MAR rather than against specific assets will significantly reduce gaming risk. ...”

- Meridian: “Meridian supports the Authority’s preference for Option 2.”

⁶ The residual options that were considered included a pure offset to Transpower’s Maximum Allowable Revenue (MAR)) (labelled option 1) and a hybrid of connection charge and residual allocation (labelled option 2).

- Nova: "The Authority has concluded that its 'preferred approach is option 2, which is to apply LCE originating from particular connection assets against connection charges for those connection assets and crediting the remaining LCE against the remainder of the MAR in bulk'. Nova favours this option out of the alternatives presented."
- Transpower: "In our submission to the October 2012 TPM issues and proposals consultation we did not support the proposal that LCE should be offset against specific assets. That was because we considered a direct asset-by-asset rebate would affect generator pricing decisions and compromise the integrity of the nodal price signal.

"We are pleased to see that the Authority has, in the LCE working paper, recognised this concern and has accounted for it in its analysis of the three options it presents. We agree, conceptually, that the LCE should be thought of as a revenue stream, albeit a decreasing one over time, to recover some of the economic cost of providing transmission services. It follows that is [sic] should be a component of the maximum allowable revenue (MAR). On balance we support option 1 which is non-distortionary and likely to be the most administratively efficient and direct way to return the surplus to consumers."

- Trustpower: "... Trustpower supports the Authority's view that Option 2 would best address the identified risks that nodal prices may be muted, and that gaming by generators may occur."
- Vector: "Vector supports Transpower retaining residual transmission rentals and auction income from locational hedges (transformed rentals) and netting them off its revenue requirement. ... i.e. they would reduce the residual charges rather than the SPD charges".

Recommendations

Entrust submits **that** the Authority:

- requires lines companies to pass-through LRR in a transparent manner,
- leaves it to lines companies to determine the method for passing-through LRR (especially as consumers, when asked, have made their view very clear) whether it is passed via retailers and/or directly to end-consumers;
- adopt an LRR allocation method which does not allocate any LRR to generators; and
- use the residual charge as the allocator, if a TPM-based method is used.⁷

Concluding remarks

The current Vector-Entrust LRR arrangements provide end-consumers with the best guarantee that they will receive the benefit of LRRs and this will reduce their electricity costs. Entrust urges the Authority to ensure its final decisions enable these arrangements to continue.

It would not be to the long-term benefit of consumers if lines companies are prevented from paying LRR to them.

⁷ If the Authority wants to use a TPM benefit-based method as the allocator it should allocate to load-only based on their relative benefits.

The Authority's proposal would best promote the long-term interests of end-consumers if all LRR is allocated to load/none is allocated to generators, as it would:

- avoid inappropriate wealth transfers from consumers to generators;
- minimise distortion to generator behaviour (consistent with previous Authority positions on this matter); and
- be most consistent with the Authority TPM decisions. It would preserve the Authority's principle that benefit-based charges should recover the covered cost of benefit-based investments and minimise the potential for LRR allocation to distort nodal or TPM pricing signals.

We ask for your consideration of our submission.

Kind Regards,

A handwritten signature in black ink, appearing to read 'A Bell', written in a cursive style.

Alastair Bell
Chair of Regulation and Policy Committee

About Entrust

Entrust (formerly Auckland Energy Consumer Trust) is a consumer trust that owns the majority of Vector on behalf of its 351,000 beneficiaries.

Entrust owns 75.1% of shares in Vector. The shares are held in trust for energy consumer beneficiaries in the Entrust District of central, east and south Auckland who are paid a cash dividend each year.

The organisation was created in 1993, to ensure that power lines owned by monopoly businesses remained in the control of electricity consumers. It was established under a trust deed for 80 years on behalf of electricity consumers in the area that used to be served by the Auckland Electric Power Board.