Entrust
Majority shareholder of Vector

20 May 2020

James Stevenson-Wallace
Chief Executive
Electricity Authority

cc: Rob Bernau

Dear James

Substantive issues with the TPM proposal and CBA remain unresolved

Entrust is writing to raise some of the substantive concerns we have about the recent transmission pricing methodology (TPM) "Information Papers".[1] The release of the Information Papers has heightened Entrust's unease about the TPM review.

The Authority has advocated variations on its TPM proposals for well over seven and half years but doesn't appear to have a robust case for the proposals. We do not consider the Information Papers provide a sound basis for rejecting the majority of stakeholders' concerns, or on which the Authority should decide to make substantive changes to the current TPM.

Summary of Entrust's concerns

- **The Authority has provided limited and selective responses to submissions and expert reports:** Entrust position remains there are clear and substantial problems with the TPM proposals. These are much broader than the issues dealt with in the Information Papers. The Authority should fully address the problems with its proposals before making final decisions.

- **Downplaying industry consensus:** While the Authority suggests it may not be possible to reach consensus on transmission pricing, there is near-consensus support for retention of some form of peak-usage pricing. This is reflected in the Authority's listing of stakeholders that support/don't support permanent peak-usage pricing.[2] Only four submitters opposed retention of permanent peak-usage charges. Adopting changes that clearly have little support are unlikely to be durable.

- **Wealth transfers are included in the CBA:** The Cost Benefit Analysis (CBA) still includes wealth transfer benefits from lower wholesale electricity prices, but nets off the adverse wealth transfers of $418m from higher transmission charges. The modelling the Authority has released indicates Aucklanders would end up paying an extra $11m each year in HVDC charges alone, and pay for assets Aucklanders don't benefit from.

[1] We are a signatory to the TPM Group's 4 May 2020 letter requesting the Authority to undertake consultation on the Cost Benefit Analysis.
[2] The list is incomplete and understates the support for peak-usage pricing e.g. Entrust has submitted that it supports retention of some form of permanent peak-usage pricing.

- **Demand should go up if prices goes down:** It is unclear how the new TPM and removal of peak-transmission charges would result in lower wholesale electricity prices or how this, in turn, would result in lower total electricity demand. It is also unclear how lower electricity consumption is supposed to make consumers better off.

- **If demand goes down it would be inefficient for investment in network infrastructure and generation to increase:** This would result in lower utilisation of infrastructure assets. This inefficiency is not modelled as the CBA model simply assumes any additional distribution and generation investment is efficient.

We remain concerned about issues of transparency

It is positive that the Authority has responded to some of the concerns raised about its proposals. Entrust and others have been calling for the Authority to provide responses to stakeholder views for some time.

The Authority should engage with substantive submission points to demonstrate it has listened to the views of stakeholders and expert advisors. The Information Papers, however, don't engage with stakeholders as well as the Authority's winbacks decision paper. The winbacks decision paper provided transparent and reasonably thorough responses to submitter views.

The limited engagement is reflected in the CBA Information Paper only being 29 pages long, and the absence of a "Technical Paper".[3] This is despite the large volume of substantial and detailed submissions and expert opinions in response to the CBA.[4]

While Entrust did not submit on the CBA in anything like the detail of some of the other submitters and expert opinions, our concerns do not appear to have been addressed. For example, we previously noted "None of the three CBAs the Authority has used as part of the TPM review are CBAs of the Authority's actual TPM plans" and "The latest CBA … is simply a CBA of replacement of the current Regional Coincident Peak Demand (RCPD) peak-usage charges with a generic TPM based on fixed or unavoidable charges and largely doesn't depend on introduction of benefit-based charges".[5]

Our concern the Authority hasn't modelled its own proposal is further confirmed by the Authority response to a CBA question that it has modelled the proposal interconnection charges as a per MWh charge, even though the benefit-based charges and residual are intended to be fixed and unavoidable charges.

The CBA is still substantially based on wealth transfer benefits

There is general industry agreement, including from Meridian's consultant, NERA, and the Authority's CBA peer review,[6] that the CBA includes wealth transfers. NERA, for example, did *"not disput[e] that the Authority's energy price effect includes transfers and that these might be large"*.[7] There is nothing obvious about the revised CBA that would invalidate these views.

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[3] The previous CBA was accompanied by a more detailed technical paper, which has not been provided for the new CBA.
[4] Our understanding is that the CBA Information Paper does not document all of the changes the Authority has made to the CBA, and some of the descriptions of changes that have been made are not accurate.
[5] Entrust 26 September 2019 submission in response to the 2019 Issues Paper.
[6] Notably the initial response to the peer review commentary about wealth transfers was to defend their inclusion as a benefit to consumers (refer to 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). We note from the information released under the Official Information Act the defence of the inclusion of wealth transfers was not challenged or disputed in the e-mail exchange by Authority staff.
[7] NERA, 2019 transmission pricing review – review of certain economic reports, 31 October 2019

The CBA modelling approach includes the wealth transfer benefits the Authority expects consumers to receive from lower wholesale electricity prices but removes the impact of the $418m increase in transmission charges.[8,9]

The CBA says prices and demand will go down

Entrust remains of the view that the revised CBA should not be relied on. We acknowledge the Authority has made some material improvements to the CBA methodology, but the vast majority of issues haven't been addressed. The CBA still has fundamental problems.

The new CBA modelling results in "Energy prices [that] are, on average, lower under the proposal", and "This is broadly true for peak, off-peak and shoulder periods - prices are lower", but total demand would go down compared to the current TPM.

Total demand should go up if wholesale electricity prices goes down and RCPD charges are removed.[10] The CBA modelling results in demand going down and more generation investment. This would be very inefficient.

The Authority has not responded to submissions that removal of RCPD charges would result in an increase in peak demand and increase wholesale electricity prices. The Authority, itself, has stated this is what would happen contradicting its own CBA. Subsequent to release of the revised CBA, the Authority stated it "agrees that removing an overly strong peak charge would increase peak demand, bring forward transmission investment, and increase spot prices at peak".[11]

The Authority is increasingly basing its proposals on static efficiency justifications

The Information Papers are entirely silent about dynamic efficiency. This is despite the Authority's long-standing view that "In regard to long-term benefit … its primary focus is to promote dynamic efficiency".[12]

The statement that "An LRMC charge sets the price too high when there is plenty of unused capacity and too low when the system is stressed" simply reflects there are trade-offs between static and dynamic efficiency. The Authority's Information Papers don't explain these trade-offs. The Authority instead focussed exclusively on the (static) detriments of peak-usage pricing and ignored the (dynamic efficiency) benefits.

Similarly, the LRMC Working Paper wasn't mentioned even though it is fundamental to issues about peak-transmission pricing.

The Authority stated "One argument put forward in support of a permanent peak charge is that nodal prices are short-run prices" and "nodal prices do not signal the cost of potential future grid investments", but didn't mention these are its own previously held

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[8] A "net consumer surplus" estimate has been used to determine benefits even though the same spreadsheet modelling also includes "total surplus" (efficiency only) estimates.
[9] Total electricity generation costs (including existing plant) would need to go down by the exact same amount as the total wholesale electricity prices for there to be no wealth transfers.
[10] We understand from the Authority's responses to questions about its CBA that it has modelled the proposal interconnection charges as a per MWh charge and this results in an increase in the cost of consuming electricity outside peak periods. What this basically means is that the Authority has modelled something which is not its proposal and consequently the outcomes of the CBA modelling are outcomes which should not happen under its proposal. We consider that this entirely invalidates the CBA.
[11] Electricity Authority, Hedge Market Enhancements Market Making, 21 April 2020.
[12] Electricity Authority, Interpretation of the Authority's statutory objective, 14 February 2011.

views.[13] It is not clear why the Authority departed from these economically orthodox views.

The Authority should consult when there is new information and material changes

We agree the Information Papers are important for re-testing the Electricity Authority's thinking. The best way to do this is to invite submissions. The Authority has noted it "always derive[s] considerable value from consulting all interested parties on significant and complex matters at each stage of a project's development".

The updated views on peak-usage pricing and the revisions to the CBA in the Information Papers have much more substantive price implications for consumers than the second-order "refinements" the Authority consulted on earlier in the year.[14] The revised CBA modelling is materially different from the previous CBA.[15] The TPM CBA result is now under half the previous value: $173m (2012), $213m (2016), $2.7b (2019) and $1.3b (2020).

While the Authority has declined the TPM Group's request for consultation on the CBA there are clearly unresolved problems with the CBA, as well as material issues with the revised methodology that stakeholders have not had an opportunity submit on. The lack of consultation and the issue of the inconsistent approach to wealth transfers alone makes it unsafe for the Authority to conclude "the current CBA is a robust estimate of benefits".

Concluding remarks

The Authority's priority should be to proactively respond to the COVID-19 crisis, and the financial pressure and hardship this will place many Kiwi households under. The other immediate priority should be implementation of the Government's Electricity Price Review reforms.

The TPM review should not be a priority at this time.

Given the amount of time the TPM review has taken so far, we don't consider a further delay would disadvantage consumers, but it would put the Authority in a stronger position to consider the potential impacts of COVID-19 and any Tiwai decisions.

For further information, contact:
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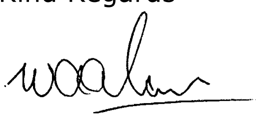
Kind Regards



William Cairns
Chairman

[13] Electricity Authority, Working Paper, Transmission Pricing Methodology Review: LRMC charges, 29 July 2014.
[14] Electricity Authority, Transmission pricing methodology: 2019 Issues paper, Supplementary consultation, 11 February 2020.
[15] The TPM CBA webinar was undertaken a short time after the release of the CBA Information Paper and CBA modelling, which included 100s of new files, and did not provide meaningful opportunity for stakeholders to engage substantively.