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28 March 2013

Submissions
Electricity Authority
PO BOX 10041
WELLINGTON

To whom it may concern,

Cross-submission to the Electricity Authority on the Transmission Pricing Methodology: Issues and proposals

Introduction

1. Vector welcomes the opportunity to make a cross-submission on the Electricity Authority's (Authority) consultation paper, "Transmission Pricing Methodology: issues and proposal" (TPM Proposal Paper), dated 19 October 2012.
2. No part of our cross-submission is confidential and we are happy for it to be made publicly available.
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Common themes and near universal disagreement with the Authority's TPM proposal

4. On the evidence that the Authority's consultation paper received a large number of submissions with only three parties offering support for the proposal (NZX (qualified support), Pacific Aluminium (qualified support) and Meridian Energy), we conclude that:
   a. the Authority has failed to demonstrate its proposal would be to the long-term benefit of consumers; and
   b. the proposed TPM should not be introduced.
5. The support from NZX and Pacific Aluminium is heavily qualified. NZX suggests the development of the SPD charge should be delayed for one to two years; the cost benefit analysis is not sufficiently developed and there should be further engagement with the industry on alternative options. Pacific Aluminium's support is limited by their view that South Island generators should continue to pay for the HVDC link, which means Pacific Aluminium and Meridian Energy are unlikely to agree on the same version of the proposed TPM.
6. While the Authority claims the current TPM is not durable, consumers (Pacific Aluminium aside) are not advocating change, and do not support a reallocation of the cost of the HVDC link.
7. We agree with the ENA that "Ultimately, if the proposals are to the long-term benefit of consumers, rather than serving the interests of generators, we would

expect to see this reflected in widespread consumer support and endorsement of the proposals".[1] Likewise, Rio Tinto comments that "If the proposed changes really were to the long term benefit of consumers wouldn't it be expected that at least some of these groups and their members would support them?"[2]

8. It is clear from the overwhelming majority of submissions that:

   a. **Alleged problems with the status quo:** There is considerable disagreement as to the extent, if any, of problems with the status quo.

   b. **Virtually no support for Authority proposal:** The Authority's proposed TPM is not supported by consumers (albeit with qualified support from Pacific Aluminium), gentailers (Meridian Energy being the sole exception), electricity distribution businesses (EDBs) or Transpower.

   c. **Substantial issues with proposal:** For the Authority to pursue its proposal a substantial range of issues would need to be addressed and additional consultation, including other TPM options, would be necessary.

   d. **Proposal is unlikely to be durable:** Based on the strength and extent of opposition to the proposal it is highly likely that the proposal would suffer from increased disputes and lobbying, not a reduction.

   e. **Proposal is detrimental to efficiency and competition:** The Authority's proposal would interfere with both static efficiency (e.g. interference with the spot market) and dynamic efficiency, and is likely to reduce retail competition. There was widespread concern about generator gaming incentives (and puzzlement that the Authority considers that gaming would actually be desirable).

   f. **Zero improvement in transmission investment efficiency:** There is no meaningful link between the proposed TPM and efficient transmission investment decision making. The general view is captured well by Reunion's statement that "we do not believe the Authority can confidently claim any dynamic efficiency benefit at all".[3]

   g. **Wealth transfers are a concern:** The TPM proposal would result in substantial wealth transfers, the effect of which have been rejected by the Authority.

   h. **Distributed generator concerns:** Distributed generation operators have expressed substantial concern about the impact of the proposal on the economics of distributed generation because of potential loss of avoided transmission revenues.

   i. **SPD method fundamentally flawed:** The proposed SPD methodology provides an unsound basis for determining beneficiaries.

   j. **SPD assets:** There is little support for applying the SPD method, if at all, to assets approved or built prior to the introduction of the proposed SPD method.

   k. **Unwarranted volatility:** If the SPD method is adopted it should be simplified to remove the uncertainty and volatility created by half-hourly pricing. Meridian Energy alone appears to be comfortable with half-hourly pricing of sunk transmission assets.

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[1] Paragraph 28 of ENA's "Response to TPAG's Transmission Pricing Discussion Paper", 12 July 2011.

[2] Paragraph 84 of Rio Tinto's "Submission on the Transmission Pricing Discussion Paper", 14 July 2011.

[3] Paragraph 9, Reunion, Report prepared for Mighty River Power, Proposed Transmission Pricing Methodology: Assessment of the CBA, February 2013.

l. **Unsound CBA:** The Authority's cost benefit analysis (CBA) is unsound and should not be relied on as evidence in favour of adopting the TPM proposal. The Authority's CBA does not attempt to demonstrate the proposal is to the long-term benefit of consumers and is narrowly based on a (flawed) assessment of (dynamic) efficiency.

Meridian Energy suggests it "is not in a position to suggest a 'better number' either in terms of the percentage improvement in dynamic efficiency arising from the Authority's proposals or the absolute value."[4] Meridian Energy may not be able to come up with a superior approach to the CBA, but it is clear from the vast majority of the submissions that: (i) the Authority's CBA should not be relied on for deciding to change the TPM, and (ii) there are clearly alternative approaches to CBA that would be more robust. Even Meridian Energy's consultant, NERA, has reason to question the quantified benefits given they question whether the Authority's main dynamic efficiency benefit (improved transmission investment) would occur in practice. NERA also suggests the Authority's CBA was not appropriate as it did not "incorporat[e] the effect on outcomes of volatility and uncertainty".[5]

Various submissions also provide useful guidance as to how the CBA could be undertaken. Attempts at alternative CBA or correcting the Authority's CBA, e.g. Castalia, Covec and Reunion, suggest the net benefits would be negative.

m. **Consumers still reject change to HVDC:** The treatment of the HVDC link remains as intractable as ever with a clear delineation between consumers (who support the status quo) and South Island generators (who do not want to pay for the HVDC). The attempted measurement of producer and consumer surpluses using the SPD method has done nothing to diffuse the level of dispute on this matter.

Meridian Energy suggests current pricing of the HVDC link may cost the company up to $1 billion.[6] Vector suggests it would be more accurate to describe this as the windfall gain Meridian Energy would receive, to the long-term detriment of consumers, from a move away from South Island generators paying for the HVDC. Consistent with this, PricewaterhouseCoopers notes that "Under the current TPM ... It is ... possible that generators may under-recover HVDC related costs. This is therefore being funded out of producer surplus".[7] Covec suggests "the HVDC change will increase profits to South Island generators without changing their market offers or expected clearing prices".[8]

n. **No common ground on alternative options:** While there is near consensus the Authority's proposed TPM should not be introduced, there is little in the way of common ground in terms of potential alternatives to the status quo.

[4] Paragraph 255, Meridian Energy, Submission on Transmission Pricing Methodology: Issues and Proposal Consultation Paper, 1 March 2013.

[5] Page 4, NERA, Memorandum to Meridian, The question "Is the proposal from the EA more efficient than the status quo?", 28 February 2013.

[6] Paragraph 19, Meridian Energy, Submission on Transmission Pricing Methodology: Issues and Proposal Consultation Paper, 1 March 2013.

[7] Paragraph 42, PricewaterhouseCoopers, Submission to the Electricity Authority on Transmission Pricing Methodology: Issues and Proposal", 1 March 2013.

[8] Page 12, Covec, Report prepared for Mighty River, Review of TPM Proposals, 28 February 2013.

Views of parties offering support for the proposed TPM

9. The three parties that offer support for the proposed TPM provide little in the way of justification for the proposal in their submissions. Meridian Energy, for example, focusses on why it does not support the current allocation of the HVDC link. The proposed TPM is not required to resolve this.

10. The reasons these three parties provide for their support of the proposed TPM are essentially:

    a. "The key advantages of the Authority's proposal are the way in which the it [sic] will: ... better promote efficient transmission investment through incentivising greater scrutiny of transmission investment; and ... promote the durability of the TPM by sheeting home costs more directly to beneficiaries";[9]

    b. Under the status quo, "some parties pay ... far more than an efficient cost for grid investments. In particular, generators, who derive significant private benefits from the interconnection assets, currently bear none of the costs";[10] and similarly

    c. "It will allocate a substantial proportion of transmission costs to beneficiaries ..."[11]

11. Vector discusses below why it does not believe any of these arguments stand up to scrutiny.

Promoting efficient transmission investment

12. Meridian Energy is the only party that supports the Authority's view that the proposal would result in stronger incentives to scrutinise transmission investment. We agree with the view of Meridian Energy's consultant, NERA, that "There are several reasons why the strength of this connection is arguable."[12]

13. The clear message from the vast majority of submissions is that the proposed TPM would be expected to have zero impact on efficient transmission investment (and could actually distort incentives to advocate for or against transmission investment approval).

14. Meridian Energy's claim that there would be greater scrutiny of transmission investment does not arise from the Authority's proposal per se, but simply from generators bearing a share of transmission charges. Any such benefits would be equally captured by Vector's enhanced status quo. This is reflected in Meridian Energy's "Illustration of incentives to scrutinise investment" where it claims it would have incentives to engage in the Commerce Commission's reviews of investment proposals even where there would be no SPD charge.

15. Meridian Energy's "Illustration of incentives to scrutinise investment" is rather curious given that any transmission cost increases due to transmission investment approval would ultimately feed into Meridian Energy and other gentailers' costs under either the status quo or the proposed TPM. Under the status quo they feed through indirectly from pass-through in distribution charges. Under the pass-through gentailers would incur them through direct charges to their generation and retail businesses. The net amount would be the same. It is not clear to Vector

[9] Paragraph 227, Meridian Energy, Submission on Transmission Pricing Methodology: Issues and Proposal Consultation Paper, 1 March 2013.

[10] Question 12, page 15, Pacific Aluminum, Submission on the transmission pricing methodology: issues and proposal, 1 March 2013.

[11] Page 1, NZX, Submission – Transmission Pricing Methodology: Issues and proposal, 1 March 2013.

[12] Page 9, NERA, Memorandum to Meridian, The question "Is the proposal from the EA more efficient than the status quo?", 28 February 2013.

why direct versus indirect charging for transmission services would have any impact on incentives to engage in consultation on transmission investment.

16. We also find Meridian Energy's claims about incentives to engage in transmission investment consultation implausible given Meridian has not submitted on the Commerce Commission's price path development for electricity and gas transmission networks, even though this is Meridian's single largest (external) cost ($380.7m for 2012[13]). We are not sure why Meridian would be incented to engage in consultation processes where the cost to them is $143,000, but not consultation processes where the cost is $380.7m? Unison made a similar comment in its submission.

Durability

17. Meridian Energy is the only party to support the view that the proposal would result in a more durable TPM.

18. It appears this view is based on an assumption the SPD method would avoid situations where some parties pay for assets that do not benefit them (or pay more than their benefit). It is clear from the assessment of the SPD method by the overwhelming majority of submissions that these contentions are not supported.

19. Furthermore, and regardless of the merit of the SPD method, Vector cannot conceive how a proposal that is opposed by virtually all industry participants and consumers would enhance durability.

Desirability of beneficiaries pay

20. The overwhelming majority of submissions highlight substantial and intractable problems with the SPD method that mean it should not be relied on to calculate consumer and generator surpluses.

21. Pacific Aluminium's concern that generators currently do not bear any of the costs of interconnection assets can be remedied by: (i) not changing the HVDC cost allocation, and (ii) splitting interconnection costs between generation and load. The SPD method and other components of the Authority's TPM proposal do not need to be introduced to achieve this.

Dynamic efficiency, locational signals and the HVDC link

22. Vector struggles to reconcile the logic of some submitters[14] that advocate for dynamic efficiency over static efficiency, but rely on a static efficiency analysis of HVDC pricing to support a change to the allocation of the cost of the HVDC link. This is the case both for the current consultation and the TPAG analysis and consultation. Similarly, we believe it is contradictory to argue locational pricing would have minimal impact on generation location decisions but to also claim the HVDC link's locational signal acts as a substantial barrier to generation investment in the South Island.

23. For example, Mighty River Power argues "There are unlikely to be material inefficiencies with the current TPM in terms of locational signals for generation and load. This is due to the weight of analysis which clearly indicates locational decisions are more likely to be influenced by other factors"[15] but Mighty River Power then claims "The treatment of the HVDC ... results in disincentives for

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[13] http://www.meridianenergy.co.nz/assets/PDF/Company/Investors/Reports-and-presentations/Annual-reports/2012/Meridian-Annual-Report-2012Online.pdf

[14] Including in relation to the previous TPAG and DM&E Framework consultation.

[15] Paragraph 2.1.27, Mighty River Power, Submission to Electricity Authority's Transmission Pricing Methodology: Issues and Proposal Consultation Paper, 1 March 2013.

efficient generation investment in the South Island".[16] Mighty River Power also cites its consultant Frontier's statement that "economic efficiency can only be promoted where such charges actually reflect the long run marginal cost (LRMC) of transmission at specific locations"[17] but does not offer any evidence the current HVDC charges conflict with this pricing principle.

24. A preference for dynamic efficiency over static efficiency for electricity transmission pricing suggests locational pricing should be considered and, at the very least, the current North-South Island locational HVDC pricing signal should be retained.

25. Vector also disagrees with Meridian Energy's unsubstantiated assertion that "the question of whether the HVDC charge is inefficient has been settled".[18]

26. In our submission to TPAG, Vector expressed some uncertainty about how the GEM model could determine locational pricing of the transmission grid which could have positive efficiency benefits that were too small to warrant locational pricing, but that locational pricing of the HVDC link had negative impacts that were material enough to warrant their removal:[19]

> Vector <u>is not persuaded</u> that removal of North-South Island locational signals to generators would result in (material) efficiency gains in the long-term. Vector <u>is unsure how to reconcile</u> that the TPAG concluded that locational-pricing of transmission would not materially influence generation investment decisions yet concluded the opposite in relation to the HVDC link

27. Vector's view on this matter has been subsequently shaped by the Biggar Report and submissions in response to the TPAG discussion paper.

28. Vector is of the view that the removal of the North-South Island locational price signals, while potentially resulting in lower generation-only costs, would be dynamically inefficient and result in higher transmission-generation costs in the long-term.

29. Vector shares the view of Rio Tinto:[20]

> The TPAG regard this as an inefficiency, but it is no more 'inefficient' than the increase in cost a generator remote from load, and requiring a substantial investment in connection assets, incurs over an equivalent plant requiring little or no such investment. It is quite rational to consider the HVDC assets as connecting surplus South Island generation to higher-priced North Island load centres.

30. The GEM analysis in the TPAG and TPM Proposal Papers suffers from methodological flaws. For example, exclusion of reliability investments from an assessment of the benefits of locational pricing inevitably results in an understatement of the benefits of locational pricing. As the Biggar Report states "most transmission investment (perhaps 90 per cent) is classified as 'reliability' investment. 'Economic' transmission investment is only a small component at best of the total transmission capital expenditure. In this light, the conclusion that

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[16] Paragraph 2.1.38, Mighty River Power, Submission to Electricity Authority's Transmission Pricing Methodology: Issues and Proposal Consultation Paper, 1 March 2013.

[17] Paragraph 3.1.4, Mighty River Power, Submission to Electricity Authority's Transmission Pricing Methodology: Issues and Proposal Consultation Paper, 1 March 2013.

[18] Paragraph 16, Meridian Energy, Submission on Transmission Pricing Methodology: Issues and Proposal Consultation Paper, 1 March 2013.

[19] Paragraph 45(c), Vector, Submission to the Electricity Authority on the TPAG Transmission Pricing discussion paper, 14 July 2011.

[20] Paragraph 60, Rio Tinto, Submission on the Transmission Pricing Discussion Paper, 14 July 2011.

there is no value in location signals for economic transmission investment seems largely irrelevant."[21]

31. The following comments from the Biggar Report and submitters are also pertinent:

> If it is true that the GEM was not set up to model the extreme demand and supply conditions which in practice drive transmission expansion then it is not clear what policy relevance to attribute to the results of that model.[22]
>
> I am concerned that the GEM conclusion that there is no value in locational signals may possibly be driven by assumptions regarding security constraints.[23]
>
> The Commission's generation expansion model (GEM) and its statement of opportunity (SoO) scenarios provide only crude forecast of a limited range of likely future states of the power system. Given the natural resources available in the South Island, there are any number of plausible scenarios in which net export capacity could increase sufficiently to justify further HVDC expansion. Similarly, there are plausible scenarios where the locational signalling effect of the HVDC link favours North Island generation sufficiently to reduce overall system costs. In any of these scenarios, the beneficiary-pays rationale remains valid and the locational signalling value of the HVDC charge is, at worst, negligible. (emphasis added)[24]

32. If the GEM modelling is correct it follows that: (i) a NPV of (maximum) $14m for the net benefit of locational pricing for the entire grid, coupled with (ii) a negative benefit with an NPV of $24±9m for the HVDC [$30m according to the TPM Proposal Paper], translates to an NPV for the introduction of locational pricing for the transmission grid excluding the HVDC of $38±9m.

33. The GEM modelling suggested locational pricing should be adopted for the grid excluding the HVDC link. If a benefit with an NPV of $24±9m is sufficient to justify a price change for the HVDC link, then a benefit of $38±9m is sufficient to justify introduction of locational pricing for the rest of the grid.

34. It would be useful to understand what it is about the pricing of the HVDC link which means that its locational pricing signal purportedly offsets a substantial portion of the (positive) benefits of locational pricing for the rest of the grid. TPAG did not answer this question because they did not properly specify a problem with the HVDC locational signals, i.e. they did not establish that the HVDC charges exceeded LRMC and therefore did not establish that the (long-run) signal to invest in the North or South Island was too strongly biased against South Island locations.

35. We highlight this, not because we think that locational pricing for the grid excluding the HVDC would be sensible, but to highlight the deficiencies of the GEM modelling. If locational pricing does not impact materially on generation location signals, then the HVDC link pricing will not materially impact on South Island generation decisions.

36. Essentially, Vector considers the reason it was concluded there would be little benefit from locational pricing of the entire transmission grid, and efficiency detriments from locational pricing of the HVDC link, is that the benefits of locational pricing have been substantially understated. We do not believe the existing TPAG or Authority HVDC analysis provides a robust basis for concluding

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[21] Page 33 of the Report prepared for the Electricity Authority by Darryl Biggar "Independent Review of "Transmission Pricing Advisory Group: Transmission Pricing Discussion Paper: 7 July 2011", 14 July 2011.

[22] Page 32 of the Report prepared for the Electricity Authority by Darryl Biggar "Independent Review of "Transmission Pricing Advisory Group: Transmission Pricing Discussion Paper: 7 July 2011", 14 July 2011.

[23] Page 41 of the Report prepared for the Electricity Authority by Darryl Biggar "Independent Review of "Transmission Pricing Advisory Group: Transmission Pricing Discussion Paper: 7 July 2011", 14 July 2011.

[24] Genesis Energy "Transmission Pricing Review: Stage 2 Options", 27 September 2010.

either that locational pricing for the entire transmission grid is not worthwhile or locational pricing of the HVDC has negative efficiency impacts.

Application of the DM&E Framework

37. The Authority's Briefing to the Incoming Minister (BIM) of January 2013 stated that "The Authority has yet to receive the considered views of any major party made after they have fully considered all the evidence <u>and attempted to propose and assess alternatives that are consistent with the Authority's decision-making and economic framework</u>" (emphasis added).[25]

38. It is not necessary for suppliers to propose alternatives in order to validate their criticisms of the Authority's proposal. Those are two separate tasks which need not be linked.

39. Further, while the Decision Making and Economic (DM&E) Framework may be a useful tool to help develop and evaluate potential TPM options, the Authority still needs to demonstrate its proposal is to the long-term benefit of consumers, including that it is better than other potential options. It is not sufficient, or even necessary, to demonstrate the option is the best feasible match to the DM&E Framework.

40. If consistency with the DM&E Framework was used as the criteria for deciding whether to change the TPM then full locational pricing of the transmission grid would appear to be the best option as: (i) it is feasible (as reflected by the tilted postage stamp proposal), and (ii) it aligns well with market-like and exacerbator pays (in contrast to the Authority's TPM proposal which predominantly attempts to satisfy beneficiary pays and administrative approaches, which are lower in the DM&E Framework's hierarchy). Likewise, the status quo better meets the Framework than the TPAG majority option, because the status quo includes a North-South Island locational signal, consistent with market-like and exacerbator pays criteria.

41. As the Authority has stated, "If the market is workably competitive and the market determines the allocation of the costs of transmission the likely outcome is that most of the costs of transmission above those incurred by the 'best' located generator, would be borne by generators, and not consumers."[26] The Authority's proposal would move the pricing of the HVDC away from this market-like allocation.

42. It is clear most submitters prefer either the status quo or the TPAG majority over the Authority's proposed TPM on the basis that it would better satisfy the Authority's statutory objective. This does not mean, nor does it need to mean, that the status quo or the TPAG majority would better meet the DM&E Framework. Vector considers the status quo or enhanced status quo to be superior to the Authority's proposal on efficiency, wealth transfer and stability grounds, none of which are explicitly captured in the DM&E Framework. Whether the status quo or enhanced status quo better meets the DM&E Framework than the TPM proposal, which poorly applies beneficiaries pay, is moot.

43. The DM&E framework <u>assumes</u> a market approach would be more efficient than a market like approach which is <u>assumed</u> to be more efficient than an exacerbator pays approach and so on. This assumption ultimately needs to be tested as part of the evaluation of TPM options. If it did not need to be tested it would be sufficient for the Authority to demonstrate that no other option better satisfied the

[25] Page 19m, Electricity Authority, Briefing to the Incoming Minister: Hon Simon Bridges, January 2013.

[26] Paragraph 4.1.14, Electricity Authority, Consultation Paper, Decision-making and economic framework for transmission pricing methodology review, 26 January 2012.

Framework, and the Authority would not need to explicitly consider whether any option met its statutory objective or conduct a quantified CBA etc.

Point of clarification: Definition of exacerbator pays

44. The definition of exacerbator pays in the DM&E Framework and in the TPM Proposal Paper differ:

DM&E Framework	TPM Proposal Paper
(a) exacerbators pay. An exacerbator is a party whose action or inaction led to a particular cost and who would change its behaviour to avoid or reduce the cost if faced with the social cost of its action or inaction;	A transmission exacerbator is a party whose actions or inactions give rise to a transmission cost and that party does not face the full, or any, cost of their action or inaction. <u>An exacerbators-pay approach is required to address market failures resulting from externalities where transmission costs are not met by the exacerbator but are instead borne by other transmission customers.</u>
The Authority considers that the exacerbators pay approach will promote efficiency by making the party or parties whose actions or inactions lead to a particular transmission cost responsible for mitigating that cost. The charge that would apply to exacerbators would reflect the additional cost of augmenting the network, over and above any already planned investments, because of the exacerbator's or exacerbators' actions or inactions. As with other options, an exacerbators pay charge must be efficient for it to be applied.	<u>An exacerbator is a party imposing negative externalities on others.</u>

45. Vector considers the DM&E Framework's definition of exacerbator pays, which is the same as "causer pays", to be appropriate.

46. The DM&E Framework makes no reference to externalities. Externalities should be treated as an example of exacerbator pays. If the Authority interpreted externalities as being the sole form of exacerbation this would be inconsistent with the DM&E Framework, and would amount to a substantial gap/flaw in the Framework.

Where to from here?

47. Vector agrees with the EMA that "There is really nothing much wrong with the existing transmission pricing system, and no real need for urgency to change it."[27]

48. Based on the views expressed in the submissions, and while Vector has considerable sympathy for locational pricing, we would suggest that the Authority either retain the status quo or, as Mighty River Power suggests, "focus on incremental reforms".[28] Where we depart from Mighty River Power is that we do not consider reallocation of the HVDC link/the TPAG (misnamed) "majority" option to be an incremental reform, given the controversial nature of the issue and the substantial impact it would have on consumer welfare.

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[27] Page 4, EMA, Transmission Pricing Methodology Consultation Paper 1, 18 February 2013.

[28] Paragraph 2, page 13, Mighty River Power, Submission to Electricity Authority's Transmission Pricing Methodology: Issues and Proposal Consultation Paper, 1 March 2013.

49. Meridian Energy claims that "there is a near consensus that the status quo can no longer be part of a modern and efficient electricity industry"[29] but this is not borne out by the facts. The TPAG consultation and TPAG recommendations to the Authority made it clear that the majority of industry participants and (all) consumers preference was for the status quo.

Status Quo	**TPAG Postage stamp transition proposal/TPAG "majority"**
Carter Holt Harvey#	*Contact Energy**+
Electricity Networks Association	MainPower New Zealand+
Domestic Energy Users' Network#	*Meridian Energy (Powershop brand)**+
*Fonterra**#	*Mighty River Power**+
*Genesis Energy**+	New Zealand Wind Energy Association+
Grey Power Federation#	*Transpower New Zealand**
Major Electricity Users' Group#	*TrustPower**+
New Zealand Steel#	Vestas+
Norske Skog Tasman#	
Orion New Zealand	
Pan Pac Forest Products#	
Powerco	
*Rio Tinto Alcan New Zealand**#	
The New Zealand Refining Company#	
*Vector**	
WEL Networks	
* *Member of TPAG* + South Island generator/South Island sites under investigation # Consumer/consumer group	

50. It is clear the status quo is preferred by more market participants and consumers than any other option presently being considered. The reality is that there is no consumer support for a shift away from South Island generators paying for the HVDC link for the simple reason such a change would not be to their long-term benefit as required by s 15 of the Electricity Industry Act 2010. Consumers would not support changes that make them worse off. As Mighty River Power concedes, in its explanation of why the Authority's proposal would make consumers worse off, "Consumers will ... bear the majority of the costs of the HVDC link, which are currently incurred by South Island generators".[30]

51. We remind the Authority of BusinessNZ's comments in relation to electricity transmission pricing:[31]

> Given the Electricity Authority's statutory objective is to promote the long-term benefit of consumers, if consumers widely/universally object to the proposal this would suggest either:
>
> a. it is not, in fact, to their long-term benefit (in which case it should not be introduced); or
>
> b. consumers are mistaken about what is in their best interests (in which case the Electricity Authority needs to make sure it makes sure it clearly spells out what the benefits consumers will receive are, and why this makes the proposal worthwhile).

52. Vector is firmly of the view that the Authority's SPD beneficiaries pays and GEM analysis are both inadequate for concluding that changes to the pricing of the HVDC link are either necessary or desirable. Substantial issues with both sets of

[29] Paragraph 15, Meridian Energy, Submission on Transmission Pricing Methodology: Issues and Proposal Consultation Paper, 1 March 2013.

[30] Paragraph 7.1, Mighty River Power, Submission to Electricity Authority's Transmission Pricing Methodology: Issues and Proposal Consultation Paper, 1 March 2013.

[31] Page 2, BusinessNZ, Transmission Pricing Discussion Paper, 14 July 2011.

analysis would need to be addressed before it could be safely determined changes should be made, and that these changes would be to the long term benefit of consumers. We would also note that if prices are between incremental and stand-alone cost they will be free of subsidies (undercharging) and economic rents (overcharging). The charges do not need to be below (or capped) at benefit to satisfy these tests. The stylised example in Vector's submission demonstrated that the SPD method's version of beneficiaries pays could result in: (i) charges no more than benefit, but (ii) that can also be below incremental cost/above stand-alone cost.

53. Castalia suggests, presumably as an attempted compromise, that the SPD method be applied to the HVDC link only. (Transpower also suggests using the SPD method to make a one-off assessment of beneficiaries.) The submissions from virtually all submitters, including Transpower and Castalia's reports, raise substantive and intractable concerns about the SPD method. Reducing the assets the SPD method applies to would not resolve these.

54. Given the views Transpower expresses about the proposed TPM, supported by the CEG report they commissioned, it is clear Transpower does not believe the Authority's proposed Methodology and Guidelines satisfy the purpose in section 15 of the Electricity Industry Act 2010. We wonder, from a practical perspective, what this would mean in terms of Transpower meeting the requirements of clause 12.89 of the Electricity Industry Participation Code 2010 to develop a methodology that is consistent with (b) the Authority's objective in section 15 of the Act; and (c) any guidelines published under clause 12.83(b). It would seem that Transpower, along with the vast majority of submitters, would not consider it possible to comply with both of these conditions if the Authority adopts its current proposal (or even a revised version of the proposal).

Concluding remarks

55. If the Authority is to ensure a durable and stable TPM it should commit to only making changes where the proposal has widespread support (not necessarily consensus) from both industry and consumers, coupled with a robust assessment that there would be substantial net benefits to consumers.

56. It needs to be recognised that no methodology is going to be perfect. The estimated efficiency loss of $30m NPV from the HVDC link, even if valid, could be seen as a small and uncertain loss given the amount of revenue it recovers.

57. Vector agrees with BusinessNZ that there "must be a high burden of proof as reflected in a demonstrably clear and certain net benefit to consumers. Any TPM also needs a high level of market participant and consumer support for it."[32] It is clear that the Authority has not satisfied any of these tests. Contact Energy also notes that "in order to obtain the hoped for benefits of reduced lobbying and disputation costs, the broad agreement of the industry should be sought before progressing changes to the TPM."[33]

58. Introduction of a TPM proposal that only has support from three parties (two of which are qualified, and two are in fundamental disagreement) cannot possibly result in durability or stability, either in absolute or relative terms.

59. No matter what the Authority does in relation to transmission pricing, anywhere between maintaining the status quo and radical overhaul of the methodology, there will always be winners and losers. The Authority cannot prevent lobbying and disputes, but clearly its actions can exacerbate and encourage lobbying and agitation for change. It is clear from submissions that virtually all submitters

[32] Page 1, BusinessNZ, Transmission Pricing Methodology Review – Issues and Proposal, 1 March 2013.

[33] Page 23, question 2, Contact Energy, Transmission Pricing Methodology, 1 March 2013.

believe that the proposed SPD method would make these problems worse, rather than go away. Meridian Energy is the only party that expresses a contrary view.

60. Finally, Vector suggests the Authority consult on how, if at all, it should further progress the TPM review. A workshop may be useful for this purpose.

Kind regards

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