

Friday, 22 July 2016

Submission to Electricity Authority: Second Issues Paper - Transmission Pricing: issues and proposals

Entrust (formerly Auckland Energy Consumer Trust) does not support the Electricity Authority (EA) proposals in its Second Issues Paper - Transmission Pricing: issues and proposals, dated 17 May 2016, which would see a multi-million-dollar increase in electricity transmission prices for Auckland consumers and businesses.

Significant negative financial impact on Aucklanders

Of particular concern to Entrust is the assertion by the Electricity Authority that the additional \$78 million increase in transmission grid charges which would be borne by Aucklanders will increase the average residential electricity bill in Auckland by \$64 per year.

This significantly underestimates the true impact on consumers. Vector has calculated the increase will be closer to \$97 each year for residential customers in the Auckland region, while businesses would face a \$148 increase each year, schools an additional \$1,577 each year and large electricity users like hospitals paying up to \$22,000 extra every year.

Corporate welfare

While the Electricity Authority highlights that some consumers gain from its proposal, the changes are of course not a zero-sum game in respect of consumers. This is because the changes see a significant welfare transfer from consumers to a few large corporate entities such as Meridian and Contact and the owners of Tiwai Smelter. Collectively, these three entities benefit financially by \$94 million a year from the proposal – an amount that will be funded by New Zealand electricity consumers.

We believe a “windfall gain” is an appropriate term for such a welfare transfer given that market analysts have already called for the likes of Meridian to pay such gain out as a special dividend to its shareholders.

Transferring significant value to corporate dividends is a highly unusual action for a regulator (particularly one which has a statutory duty to act for the long-term benefit of consumers). For example, key changes around how charges are levied for the HVDC link has the effect of transferring \$750 million over 20 years from North Island consumers to South Island generators. The Authority’s key objective in making such a change appears to be an estimated efficiency gain of a mere \$13 million over the same 20 years. Such a significant welfare transfer relative to such a small efficiency gain cannot be in the long term benefit of consumers.

Entrust does not support a proposal that results in such an unfair redistribution of transmission costs from those least able to afford it to major corporate consumers and generators, particularly when the EA has shown no sound basis for doing so. While the Authority believes its changes will be more durable, such changes will simply transfer grievances to consumers, and, as such are unlikely to be durable.

Generators should pay their fair share of costs

We understand the EA proposal would see 91% of Transpower's costs loaded onto consumers and only 9% allocated to generators. This compares to the current split of 80:20 between consumers and generators. This is despite generators clearly also benefiting from the grid in allowing them to transport their goods to market.

There are no reasonable grounds for tilting even further the bulk of transmission charges onto consumers. Of course, consumers stand to be made even worse off given the EA is proposing to implement a subsidy scheme whereby it will be lobbied to approve ad hoc subsidies to industry on the basis of hardship. To the extent such subsidies are approved by the EA, they will represent further wealth transfers at the cost of residential households that make such consumers even worse off.

Service based pricing will dampen economic growth

Our understanding of the EA concept of "service based pricing" implies Aucklanders are somehow receiving a higher standard than N-1 for reliability. Entrust does not believe Auckland is receiving greater quality of service for grid services than other parts of the country. Auckland does not receive, nor is guaranteed, a higher reliability standard than the rest of New Zealand. Instead, recent upgrades to Auckland and the upper North Island in response to growth supports the continuation of a reliability standard that is afforded to grid users across the country. To the extent the EA now wish to see pricing on Auckland that implies a higher service standard, then such pricing risks dampening economic growth in the Auckland region.

Retrospective changes undermine investment in the sector

Making retrospective changes to regulation is universally recognised as bad practice given it undermines investor confidence and raises the cost of capital in the sector and the wider infrastructure community. The EA's proposal will create significant uncertainty going forward as it sends a very chilling signal that businesses cannot rely on stable regulatory rules or the fact that retrospective changes will not be made in regard to sunk asset and locational decisions that have already been taken. The EA appear not to recognise the harmful impact on investment incentives from its proposal, particularly in the context of significant ongoing investment required for Auckland infrastructure growth.

Entrust calls on the EA to acknowledge that applying 'beneficiary pays' to sunk investments will only ever deliver limited efficiency benefits – while simply raising the cost of capital for those in the sector and encouraging perverse behaviour such as changing utilisation of assets for little or no benefit.

Arbitrary decisions represent bad practice

We have serious reservations about some very arbitrary calls proposed by the EA. Arbitrary calls with weak justification cannot represent good regulation. For example, the EA principle for 'beneficiary pays' appears highly selective with an arbitrary date of 2004 for relevant investments being selected and different valuation methodologies for different assets

The EA also appears to be providing inconsistent messages for the wider electricity sector. For example, we cannot understand why the EA is proposing to remove peak demand pricing for transmission pricing while at the same time recommending it for distribution pricing.

This fundamental inconsistency at a policy level further undermines the integrity of good regulatory decision making and sends mixed signals to the wider industry.

Proposed approach is not durable

We strongly disagree with the EA claim that this latest transmission pricing proposal will be durable (and therefore represents a key benefit of change). The changes which significantly benefit generators have already attracted the attention of large numbers of electricity consumers who are strongly opposed to the changes. We cannot see how changes which result in such large welfare transfers against consumers, but in the interests of particular generators, could ever be considered durable.

The Trustees of Entrust, are so concerned about the impact of the proposals on Auckland consumers that a Facebook campaign, including a hip-hop video <https://www.facebook.com/entrustnz/> was launched to explain the impact and to seek feedback from electricity consumers.

To date the hip-hop video has been viewed by 234,068 people and we have received a lot of support for bringing this important issue to the attention of Aucklanders. A video file is included as part of this submission.

Rather than resolve the issue of 'durability', this proposal has triggered a strong response from many people who do not believe the EA proposal is fair. We, along with many Aucklanders, will continue to push back on this proposal.

Comments from consumers

Electricity consumers have been clear in their lack of support for the proposals. Some examples of comments are listed below. The full list of comments can be viewed on the Entrust Facebook page: <https://www.facebook.com/entrustnz/>

- If that goes ahead many people will not be able to keep warm through the winter, will not be able to heat their homes adequately, the cost of living is too hard now, why make it worse for people?
- Not a good plan, will mean more expense for those who can least afford it
- What the heck....Auckland is fast becoming a 'rip off'.....each year, the rates, the premiums, the electricity charges, the water charges on an average go up between 17 to 22 per cent....something is drastically wrong....somewhere.....!
- We already can't afford housing now electricity too
- I think we already pay enough for power as it is let alone another hike. Alright for people who earn millions
- Stop targeting people in Auckland please.
- Everyone one in NZ should pay the same amount for power - we all use it! Maybe the rest of the country would like to pay road tolls for Auckland roads - since most of the money to pave roads throughout the country comes from Auckland
- R u willing to up our pension so we can pay for it
- No to power increases

Next steps

Entrust encourages the EA to reconsider its proposals. The TPM proposal is of such significance to New Zealand and the electricity market that reconsideration would be best achieved through an independent and international expert review of the proposal.


Entrust is confident that any independent expert review will reiterate to the EA what has been previously highlighted to it, but ignored, in prior consultation rounds (such as by Compass Lexecon and Profs. Schoeters and Spiller), that the best TPM is one that recovers sunk costs with minimum distortions, that is, that impacts the least on consumption, generation and investment decisions. This is sometimes labelled a 'wide base' approach as it seeks to spread transmission costs fairly across all beneficiaries of the grid including generators as well as consumers.

Entrust continues to believe that such an approach is a fairer and more robust alternative to what the EA propose and a far superior approach that needs to be investigated further.

For further information, contact:

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Kind regards



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Appendix: Hip-Hop video

Entrust and Waiheke Island's Hip Op-eration crew joined forces to say 'No' to the EA proposals via development of a hip-hop dance video <https://www.facebook.com/entrustnz/> which explains the impact of the proposal on Aucklanders.

Hip-hip video lyrics

Hey Mr Big EA, watcha doing to your homies in the hood,
Your Auckland power increases ain't no good!

We can't keep warm in our homes at night,
With a seventy-eight-million-dollar price hike

That's an extra hundred bucks a year for us each to pay,
It's way too much Mr Big EA

All the people that make up the Auckland economy,
Will be hurt by this - don't you see

We're just families, businesses and pensioners - you gotta know what plight,
Using us to make cash for generators just ain't right

Doesn't make sense
At our expense

Electricity is a basic need for everyone, so we want you to hear
Your annual increase – common on man, it's just not fair

We hope this rap will make you think carefully,
About increasing the price of Auckland electricity

So please hear us out and do what's good,
Switch your decision; think of your homies in the hood!

Word!