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Submission on Commerce Commission Issues Paper: Transpower's individual price quality path for the next regulatory control period

Thank you for the opportunity to comment on the Commerce Commission's (the Commission) issues paper "*Transpower's individual price-quality path for the next regulatory control period*"[1] published for consultation on 25 January 2024.

Transmission is a critical issue for New Zealand electricity users, and it is paramount that provision of transmission is efficient and economically sustainable for electricity users, including major employers such as NZAS.

Background to NZAS

NZAS is a joint venture between Rio Tinto (79.36%) and Sumitomo Chemical Company (20.64%), of Japan.

Tiwai first produced aluminium in 1971 and each year the smelter produces more than 330,000 tonnes of the world's purest aluminium using electricity from renewable sources. As a consequence, New Zealand produced aluminium is highly sought after internationally.

Each year, NZAS contributes approximately $406 million to the Southland economy (6.5% of Southland's GDP) with annual export revenue of about $1 billion.

In 2022, NZAS produced 333,689 tonnes of aluminium. It paid $357 million to New Zealand suppliers, including $77 million to suppliers in Southland. It was New Zealand's 10th largest export in 2022.

Approximately 1,000 fulltime-equivalent employees and contractors work at the smelter, with an estimated further 2200 people offsite employed indirectly. NZAS also paid a total of $96 million in salaries and benefits to employees.

Comments on the Commission's issues paper

NZAS is a member of the Major Electricity Users Group (MEUG). We have reviewed MEUG's submission, which we support. We note that the MEUG submission includes more specific detail on the questions you have asked in your consultation paper.

In addition to the points raised by MEUG, we wish to make some overarching general points in relation to Transpower's proposed expenditure path under RCP4, as follows:

[1] https://comcom.govt.nz/__data/assets/pdf_file/0020/341435/Transpower-RCP4-Issues-Paper-25-January-2024.pdf

1. The rate of overall increase is steep and is contrary to the approach agreed in the TPM

The new Transmission Pricing Methodology (TPM), which came into effect in 2002, was designed to allocate charges to customers, based on the benefit they receive, rather than 'washing across' customers. Specifically, as noted in the TPM project background[2]:

The new TPM will encourage more efficient use of the grid, and more efficient investment in transmission and generation assets. It will:

- *Reduce the cost of electricity at peak times when New Zealanders want to use it most*
- *Ensure that those who set to benefit from areas of grid investment will pay for it*
- *Lead to lower prices in the long-term for delivered electricity.*

It was NZAS' expectation that these charges would continue to decline over time as Transpower allocated less of its revenue recovery to the residual charge 'washed across' customers, and more to those who benefit from on-going grid expenditure.

Transpower's proposal shows smoothing that would result in a 39.5% step change in the allowable revenue between the last year of RCP3 and the first year of RCP4, and includes a 5.0% annual growth rate which accounts for increasing forecasted inflation and higher weighted average cost of capital (WACC).

NZCC has calculated that this step change will be 24.9% once the outcomes from the 2023 IM Review decision to index Transpower's RAB to inflation are applied.

As a consequence, NZAS' annual transmission charges would increase from approximately NZ$46 million for the 2024 pricing year, to approximately, NZ$66 million per annum (equating to an approximately $4.0/MWh increase to delivered electricity costs) by the 2029 pricing year.

NZAS feels strongly that this increase goes against the long-run policy intent, across several governments, that the TPM be a benefit-based regime – with those grid users, like generators, who will ultimately be the beneficiary of increased power supply, paying proportionality.

NZAS' relatively fixed line usage means it will see little to no additional benefit, while paying substantially more for transmission than is presently the case. As NZAS operates in a globally competitive market, such significant increases have a material impact on the economic sustainability of the smelter, and risks increasing regulatory uncertainty over the long term that drives up the perception of New Zealand's sovereign risk.

2. Transpower's WACC settings need to be revisited

NZAS believes the issue of the WACC for price-quality regulated entities including Transpower is a key issue that has not been adequately debated within the industry, as evidenced by the tight submission timeframe on Transpower's draft IM determination (where only Vector was able to submit alongside Transpower).

NZAS believes there is a very strong case, and international precedent, to set Transpower's WACC at the 50th percentile. Transpower is unique in that it is 100% government owned and this ownership structure, level of transparency and informational disclosure afforded by the Information Disclosure

[2] Transmission pricing methodology | Our projects | Electricity Authority (ea.govt.nz)

regime and high degree of engagement with industry, substantially lowers the underinvestment risk for which a WACC premium is intended to compensate.

As the New Zealand energy industry approaches rapid decarbonisation underpinned by significant transmission and distribution infrastructure investment[3], regulatory settings that overcompensate for potential risks will have a significant impact on consumers ability to engage in and [afford] the transition to a low carbon energy sector. Decarbonisation faces multiple challenges to producing an efficient and economically affordable solution. Adding unnecessary or inappropriate regulatory friction costs will not operate to support that transition.

While outside the scope of the current consultation, NZAS believes this issue is germane and one of the key regulatory judgements that the Commerce Commission has made with inadequate reflection and consultation with industry participants given its compressed consultation timeframe.

NZAS believes this is also a key policy matter for NZ's electricity sector that unaddressed will cause a significant cost burden on consumers and risk large consumers investing to decarbonize.

3. Components of RCP4 allowable revenue have not been adequately supported nor examined

NZAS questions the appropriateness of the inherent assumption in Transpower's RCP submission that historical investments have been efficient (as that forms the basis for base, step and trend analysis and determination of RCP4 capex and opex) and supports the Commerce Commission examining this further. The Verifier engaged by Transpower did not benchmark cost performance / efficiency of Transpower (e.g. by benchmarking against international transmission grid operators).

The base, step and trend used inherently assumes historical expenditure is a reasonable or "efficient" basis for projecting future costs. NZAS believes that the industry would take more comfort in Transpower's cost projections, in the absence of other transmission investors in the NZ market, through comprehensive cost benchmarking with transmission owners in other jurisdictions such as Australia.

4. Appropriate criteria need to be applied to anticipatory expenditure allowed within RCP4

NZAS is supportive of a shift towards anticipatory investment to support the transition to an electrified electricity sector, but it believes that Transpower should have a clear set of gating criteria, and prioritisation, to provide industry with confidence that this investment will be appropriately selected, sequenced, utilised and not stranded, and ultimately becoming a cost that grid users bear.

5. Deliverability

We have noted the Commission's comments relating to concerns about Transpower's ability to deliver the proposed work programme. We share these concerns. The market for the skills that Transpower will require, which are similar to skills required across both the electricity and industrial sectors is very constrained and highly competitive, and we would strongly suggest that any forward-looking work programme factor in more fully the reality of current labour market conditions.

[3] Refer Transmission and Distribution investments required to 2050 in the BCG "Future is Electric" Report

6. **The Crown's ownership model provides an opportunity to ease the affordability of this transition on consumers**

NZAS believes the Crown's 100% ownership of Transpower affords a unique opportunity to address the question of consumer affordability during the transition.

Transpower's status as an SOE, and regulatory settings (such as inputs into the determination of WACC including Transpower's standalone credit rating) creates an outcome where consumers bear the burden of a dividend flow back to the Crown (of over $300 million over the last three financial years). NZAS believes the Crown could take a different view, that dividends could be foregone to reduce the significant uplift in costs to grid users that the transition to RCP4 will see, partly driven by macroeconomic factors, and partly due to the increased investment that the decarbonization of the energy sector will demand.

Conclusion

The transition to an electrified, low carbon economy in New Zealand needs to be enabled by efficient and prudent pricing for infrastructure services. The cumulative effects of the transmission ownership model, overly conservative regulatory settings, a potentially inefficient delivery model, and a TPM that is not being applied as originally envisioned, risk creating additional and unnecessary costs for grid users. With a reset in energy policy and a clearer understanding of the size and cost of the transition towards Net Zero 2050, NZAS would argue that this is the moment to ensure unnecessary barriers and efficiencies are removed.

We would be happy to speak to the Commission on this matter as you continue your deliberations.

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