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TPM 2019 Issues Paper Supplementary Consultation

This is Transpower's submission in response to the Authority's Transmission Pricing Methodology (TPM) 2019 Issues Paper supplementary consultation.

The Authority has proposed four amendments to the proposals in its 2019 Issue Paper. Our lens for responding to the proposed amendments, as for our response to the 2019 Issues Paper, is to ensure workability in developing, implementing and administering the proposed new TPM. Our views about the overall efficacy of the proposed new TPM are unchanged.

Summary of Transpower's views of the supplementary proposals:

- **Prudent discount for charges above stand-alone cost (SAC)**: This proposed amendment appears workable if the Guidelines align with the previous Authority proposal to place the burden of proof on the applicant. We consider that the Authority should be the ultimate decision-maker for SAC prudent discounts, not Transpower, because of the wealth transfer impact of a successful application.
- **Recovery profile for future benefit-based investments:** While our pricing efficiency concern remains, we consider that using Depreciated Historic Cost (DHC) for the recovery profile for future benefit-based investments is likely to be more straightforward than using Indexed Historic Cost (IHC). We consider that a much more material workability issue, not addressed by the proposed amendments, is the impracticability of applying optimisation (reassignment) to an historic cost valuation, whether it be DHC or IHC.
- **Adjusting benefit-based charges when a plant closes:** We defer to our customers' views on the efficiency of a 10-year charging period following plant closure (where the customer remains grid-connected elsewhere).
- **Regular updating of the residual charge allocation**: We support including an ability for Transpower to update the residual charge allocation to reflect changes in the use of the grid. However, we do not consider the Authority has demonstrated that historic lagged gross anytime maximum demand (AMD) is the best option for initial allocation of the residual charge.

The proposed revisions would have been clearer if the supplementary consultation had included draft TPM guidelines reflecting the amendments. We support further technical consultation on the drafting of the TPM guidelines.

The SAC prudent discount appears workable, subject to the detail

We outline below our high-level views on the design features needed for the SAC prudent discount policy. These design features do not necessarily need to be reflected in the TPM guidelines, but the TPM guidelines should not preclude any of them.

- Any applicant for a SAC prudent discount (or for any other pricing adjustment, such as asset value optimisation) should be required to pay an application fee to cover Transpower's estimated costs of assessing the application. This fee would help deter speculative applications, which may otherwise be encouraged given that feasibility of the alternative project will not be a pre-requisite for a SAC prudent discount.[1]
- The burden of proving that the applicant's transmission charges are in excess of SAC should be on the applicant.
- The Authority should decide whether to approve a SAC prudent discount in a similar way to the mechanisms provided for major capex approvals (MCP) under Part 4 of the Commerce Act. Transpower's role should be to act as "gate-keeper", that is to assess the information provided by the applicant, decide whether the application has merit, and make a recommendation to the Authority. We do not consider it appropriate for Transpower to be the decision-maker for a form of prudent discount that is likely to have significant wealth transfer effects.[2]
- The duration of a SAC prudent discount should be limited to a reasonable period (indicatively 15 years) to reflect that making predictions further out on power system developments and transmission charges is not practical.[3] The recipient of an SAC prudent discount could re-apply for the discount near the end of the term.
- The Authority should consult with other agencies (such as the Commerce Commission and Treasury), industry participants, consumers and other interested parties before deciding whether to approve a SAC prudent discount and on the value of the discount.

Q6. Should a load customer be eligible for a prudent discount if it can establish that its transmission charges exceed the efficient greenfield standalone cost of supply? *Yes*

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1 We note that under Part 4 of the Commerce Act, regulated suppliers seeking a Customised Price Path (CPP) have to pay an application fee, and are subject to the risk the CPP could make them worse off. The Telecommunications Act has similar arrangements.

2 This contrasts with the currently available form of prudent discount, which typically will not have significant wealth transfer effects.

3 As we have previously submitted, we do not agree with the Authority's proposal to remove the duration limit from the prudent discount policy generally.

A DHC recovery profile for future benefit-based investments is more workable

The Authority had previously proposed DHC as the valuation method for future benefit-based investments, and then proposed IHC. The current proposal to require use of DHC was considered in our 2017 cross-submission[4] on valuation method which outlined that:

> "a combination of beneficiaries-pay and depreciated asset valuation would result in charges falling as transmission becomes constrained and as the aggregate private benefits (and LRMC) increase. This is potentially the opposite of a dynamically-efficient price signal and beneficiaries-pay principles."

Our pricing efficiency concern remains, but we acknowledge DHC would be more straightforward for Transpower to administer.

We also submitted,[5] in response to the 2019 Issues Paper, that the TPM guidelines should provide for Transpower to use an alternative valuation method if it would better meet the Authority's statutory objective and fully recover the cost of the investment.

Q1. Should the annual benefit-based charges that recover the costs of post-2019 investments be set using DHC, IHC or some other approach?

See response below.

Q2. Should Transpower be required to use the DHC as proposed, or should it be able to propose a different method if that better met the Authority's statutory objective?

We support the existing proposed TPM guidelines provision that Transpower can propose an alternative valuation method.

We defer to customer views on continuing charges following plant closure

We defer to our customers' views on the efficiency of a 10-year charging period following plant closure (where the customer remains grid-connected elsewhere).

Q3. If a transmission customer closes one of its plants, should its liability for associated benefit-based charges continue indefinitely, cease immediately or cease after a specified period of time has elapsed since the commissioning dates of the relevant grid investments? If the latter, should that period be 5, 10 or 20 years? Should the relevant period be expressed relative to the commissioning date of the investment or some other period?

No comment on the liability period, but the period should be assessed from the commissioning date as that date is when the relevant assets become part of our regulated asset base.

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4 Transpower, TPM Supplementary Consultation: cross-submission on asset valuation, 24 March 2017

5 Transpower, Submission: Transmission pricing review 2019 issues paper, 1 October 2019

The residual charge should be able to be updated, but not necessarily using historic lagged gross AMD

We support including an ability for Transpower to update the residual charge allocation to reflect changes in the use of the grid. We consider that the proposed TPM guidelines should retain the provision allowing Transpower to propose an alternative method for allocating the residual charge to the default allocator of historic lagged gross AMD.

A large number of submitters on the 2019 Issues Paper raised issues with the use of historic gross AMD as the residual charge allocator, which went well beyond whether the allocator should be permanently fixed and included issues about the efficacy of the allocator. These matters should be addressed before a final decision on the appropriate allocator can be made (whether by the Authority or Transpower). This might require analysis similar to that which we undertook during our operational review to determine whether the HVDC charge allocator should be changed from HAMI to SIMI.

Q4. Should the guidelines stipulate for regular updates to the residual charge allocation?

We do not agree that the use of historic lagged gross AMD (or any other type of allocator) should be mandated in the TPM guidelines as the allocator.

Q5. If so, is the revised proposal an appropriate way to provide for such updates?

Yours sincerely

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