

14 September 2020

Transpower Ltd  
PO Box 1021  
Wellington 6140.

By email to [TPM@transpower.co.nz](mailto:TPM@transpower.co.nz)

**Re: Feedback on proposed changes to Connection charges**

Dear Transpower

We are pleased to be able to provide feedback to Transpower on the Connection Charges Consultation Paper. For us this is the beginning of a very important implementation process of the TPM and we want to ensure that we have effective engagement with Transpower throughout the implementation process. The ENA has established a TPM work group of members to assist it with responding to Transpower consultations on final design and implementation of the TPM. Individual members will, of course, represent their own organisation views.

**Our answers to consultation questions**

**TPM drafting tidy-up**

*Question 1.1 - Do you have any comments on our initial assessment? Is this a material issue?*

On the face of it this seems sensible housekeeping to undertake. We have no other comments.

**Classification of assets during staged commissioning**

*Question 2.1 Do you have any comments on our initial assessment?*

Capturing construction efficiencies with connection assets seems a sensible approach provided it does not encourage avoidance of charges. We support the proposed changes.

*Question 2.2 Which of the options presented do you support, and why?*

Options 2 or 3 seem to be the more sensible ones because of a clear price path that accounts for the staging of asset build, and they are more consistent with the beneficiaries pays ethos of the TPM.

### **Effect of other parties connecting to grid assets**

*Question 3.1 Do you have any comments on our initial assessment?*

The assessment in the consultation paper seems to be an EA assessment rather than Transpower's [it is a restatement of EA views]. In principle the approach seems sensible, but perhaps the decision should be based on some sort of cost-benefit assessment.

*Question 3.2 Which of the options presented do you support, and why?*

Again, the beneficiaries pay ethos of the TPM would suggest that if Transpower does not require a link, then connection assets should not be classified as interconnection assets.

*Question 3.3 Are there any other options, or approaches under the presented options, for addressing this focus area we should consider?*

See answer to Q 3.2

*Question 3.4 Do you have any comments on our TPM drafting suggestions?*

No

### **Regular updating of replacement cost building blocks**

*Question 4.1 Do you have any comments on our initial assessment? Is this a material issue?*

We support the overall approach to update the costs pending details regarding the approach and the impacts on connection charges.

*Question 4.2 Do you support our suggested approach? If not, why not?*

The objective would seem to be that connection customers face a reasonable allocation of connection costs. The allocators should be reasonable, but there may be a lower cost way of ensuring that the allocators generate fair outcomes, especially when new assets are added in at current values.

*Question 4.3 Are there any other options for addressing this focus area we should consider?*

We know from experience that updating costs and cost allocation methodologies is a time consuming and costly process. It may be prudent to short-cut the costs and time and use an index approach to bring the costs up to date.

*Question 4.4 Do you have any comments on our TPM drafting suggestions?*

No.

### **Introduction of cable line type for maintenance costs**

*Question 5.1 Do you have any comments on our initial assessment? Is this a material issue?*

The underground maintenance costs overall are less than 2% of all line maintenance costs so this may not be a priority issue but rather a 'future-proofing' of connection costs. Acting on this focus area will depend on the amount of effort that is required versus other higher priority focus areas. Also, we wonder if the \$10,000 estimate for underground cables is on the high side and whether the age of the cables has been taken into consideration.

*Question 5.2 Which of the options presented do you support, and why?*

Either option 3 or 4 seem to be a sensible approach.

*Question 5.3 Are there any other options, or approaches under the presented options, for addressing this focus area we should consider?*

No

*Question 5.4 Do you have any comments on our TPM drafting suggestions?*

No

### **Investment contract arrangements**

*Question 6.1 Do you have any comments on our initial assessment? Is this a material issue?*

Transpower's proposals are to ensure consistency between the recovery of capital and maintenance costs that are jointly funded through a mix of regulated and contracted terms.

ENA supports Transpower's proposals, but we think that Transpower should consider the wider implications of the approaches to recovery of contracted connection assets and regulated connection assets. How to accommodate investment contracts has been subject to recent discussion between the ENA board and Transpower. This discussion included an exchange of letters that is relevant to focus area 6.

During these talks in August, ENA put forward a suggestion that Transpower could seek changes to enable it to classify some or all works spending currently covered under a Transmission Works Agreement as a connection asset. These monies would therefore be recoverable under the Transmission Pricing Methodology as regulated income over the estimated life of the asset.

At present, Transpower is restricted from classifying customer-initiated works (such as new or upgraded GXPs) as connection assets. The current TPM takes an all-or-nothing approach, which means new or upgraded assets paid by distributors are included as \$0 and are therefore not recoverable through the TPM.

ENA would like either more assets to be included as regulated connection assets, or consistency of treatment between regulated and contracted connection assets. For example, some of these new or upgraded assets could be classified as connection assets. This would allow for cost recovery over the extended life of the assets accompanied by a return set by the Commerce commission through the regulated WACC.

This would help address a significant problem which has emerged, where Transpower is seeking to recover investment works monies from EDBs in shortened time frames. It is insisting on recovery times much less than the life of the asset and adding a significant margin to the WACC for cost recovery dated over 5 years. In principle, a customer-initiated investment repaid over 55 years would add 2.5 percentage to the WACC, an unrealistic amount.

Transpower's reluctance to contract for terms approaching anywhere near the expected physical life of the asset represents a significant inter-generational inequity, especially where connection assets are sized to meet long-term capacity requirements.

However, any assets which continue to be funded through investment contracts must receive a finance rate and investment term not dissimilar to the regulated approaches, given they are fundamentally similar assets with the same low-risk counterparties (in the case of EDBs).

*Question 6.2 Which of the options presented do you support, and why?*

We support options 2 and 3, allowing capital and maintenance costs to be recovered via connection charges where this is appropriate. The discretion to utilise these options should sit with the party contracting with Transpower [rather than having a mandated approach].

*Question 6.3 Are there any other options, or approaches under the presented options, for addressing this focus area we should consider?*

No

*Question 6.4 Do you have any comments on our TPM drafting suggestions?*

No

### **Connection asset decommissioning costs**

*Question 7.1 Do you have any comments on our initial assessment? Is this a material issue?*

In principle, connection assets could be decommissioned from either an agreed connection contract which should set out where and how the decommissioning costs fall.

*Question 7.2 Which of the options presented do you support, and why?*

It is not clear to us how option 2 would work but regardless we do not support the blanket allocation of decommissioning costs to what could be a limited group of remaining customers.

*Question 7.3 Under option 3, are there any specific circumstances where a relevant customer should not incur the cost, or the full cost, of decommissioning the connection asset?*

For existing contracts that may not specify costs on termination we do not consider that it is viable to pursue the exiting party for costs. For these situations it may be that the only reasonable option is to socialise the cost across all transmission customers through the residual charge.

If a customer defaults, decommissioning costs are likely best recovered through the residual charge simply because Part 4 regulation does not compensate Transpower for stranding risk. This may also apply in situations where recovery of decommissioning costs from remaining connection customers would result in an objectively unreasonable outcome [e.g., a disproportionate financial impact relative to the size of the customer].

*Question 7.4 Are there any other options, or approaches under the presented options, for addressing this focus area we should consider?*

No

*Question 7.5 Do you have any comments on our TPM drafting suggestions?*

No

### **First mover disadvantage**

*Question 8.1 Do you have any comments on our initial assessment? Is this a material issue?*

We agree that first mover advantage is a potential issue, but we do not have a strong sense as to how material an issue it may be. It may be a greater issue for injection customers than off-take customers as there are likely to be relatively few instances where off-take connection assets would be shared.

In the case of upgrades of assets to EDB off-take customers, the EDB is generally incentivised to 'right-size' the connection asset capacity to meet reasonably foreseeable load growth over the investment time horizon. Scale economies also make it easier to justify capacity increments that err on the side of over-sizing, as incremental costs of capacity will tend to be modest.

The bigger problem [or a problem that compounds first mover disadvantage] is Transpower's approach to recovery of asset costs subject to investment contracts. Transpower's default offering is to recover connection asset costs, that are subject to investment contracts, over a five-year term. Where an EDB customer seeks a longer term, Transpower wishes to recover a 5 basis point per annum premium for every year beyond five years.

If a customer sought to align the cost recovery term under an investment contract with that under regulated terms [which can be 55 years for a transformer, for example], in principle, the customer would have to pay a 2.5% per annum premium, although Transpower will not contract for such terms. The consequence is that early consumers (those in the first five years) potentially pay a unit price that can be more than 370% higher than a customer on regulated terms. Customers joining after five years (assuming the offtake customer does not wish to pay a WACC-premium) are entitled to a free-ride as there is no means by which Transpower can compensate the first mover.

ENA's strong recommendation is that Transpower needs to reconsider its approach to connection investment contracts to ensure they are aligned to long-term interests of end consumers. One way to achieve this is to consider recovering costs using a constant unit price over the life of the asset, by assuming a linear increase in the use of connection capacity over time. For example, if starting capacity utilisation of an 80MVA transformer is 50 MVA and the 80 MVA is expected to be used at the end of the 55 year assumed life for a transformer, Transpower could develop a price profile that better ensures a constant revenue per MVA over the 55 year life.

*Question 8.2 Do you have any comments on the strawman option we have presented for addressing Type 1 first mover disadvantage?*

The cost reallocation approach that is illustrated in the consultation paper seems to be straight forward and sensible but our comments in 8.1 above are relevant. Also, we would be interested in a discussion on whether the approach would apply to interconnection assets as well and whether the strawman could work there as opposed to other approaches.

*Question 8.3 Are there any other options for addressing Type 1 first mover disadvantage we should consider?*

As stated above, Transpower should consider revenue recovery profiles that better align to asset utilisation over the expected physical life of the asset, which would better ensure that first movers face less disadvantage when transmission upgrades are made.

*Question 8.4 Should we do anything to address Type 2 first mover disadvantage, and if so, what do you suggest?*

ENA offers the following for consideration:

Type 2 scenarios exist when a speculative investment is made in capacity that may be used in future. In most instances an EDB is the off-take customer and it is incentivised to identify a level of capacity that will be most economic over the planning horizon, taking into account

past trends and known new future demands. In this situation, investment contracts will be based on the EDB customer agreeing to a level of capacity.

As noted earlier, the principle problem facing customers funding new connection assets through investment contracts is the lack of alignment between Transpower's cost recovery approach and use of the asset over time. If Transpower improved its cost recovery approach, much of the problem would go away as revenues would grow with new demands arising over time.

It would seem to ENA that the more problematic circumstance is where Transpower is investing in connection assets for injection customers, in particular where future injection customers might also be expected to connect because of availability of fuel sources in the region. In this instance, scaling the initial connection assets to the requirements of the first mover could lead to significant inefficiency if assets must subsequently be replaced with larger units. For us, the following questions are relevant:

1. who has decision rights over the size of the connection capacity;
2. who must fund the asset in the interim before subsequent consumers connect; and
3. who funds the asset if demand for the investment does not materialise.

If Transpower is provisioning assets to accommodate future requirements beyond that of the initial customer, it would be unreasonable to require the initial customer to pay for the entire asset cost, which then only leaves either Transpower or socialisation as the options to cover the investment costs.

If the assets are not regulated connection assets then it would seem that Transpower's only option would be to take the risk on future demand for the assets materialising, and assessing a finance rate that takes account of the risk that a counter-party does not show up. If the assets are to be regulated connection assets, subject to an external approval process by the Commerce Commission and only permitted to earn the regulated WACC, then the excess capacity would need to be funded through the residual charge.

Overall, funding the provision of excess transmission capacity in light of uncertain future demand is challenging. We do not consider it would be appropriate for the first mover to fund excess capacity, but the chief consideration in deciding on whether to provide the excess capacity should be to ensure that the funder is kept whole (on an expectations basis). Any party taking risk or contributing to funding the investment should gain some benefit from doing so.

We trust you will find these comments useful and we are happy to discuss any of them with you.

Once again thanks for the opportunity to comment.

Kind regards

A handwritten signature in grey ink, appearing to be 'd. boer', written in a cursive style.

David de Boer  
Principal Advisor

Electricity Networks Association