



MAJOR ELECTRICITY USERS' GROUP

26 April 2007

Opening comments to EC conference on Transmission Pricing Methodology

Good morning.

MEUG welcomes the opportunity to be heard at this conference. I'll spend less than five minutes making some introductory remarks and will then pass over to Brent Layton of NZIER who will comment in detail on the draft TPM.

MEUG members collectively use just under 30% of New Zealand's electricity and transform that through their various manufacturing processes into income that contributes to GDP and makes us all wealthier.

Members of MEUG, just as any other manufacturer or provider of services in the economy, have continuous pressures to tailor their products for what consumers want and to carry no unwarranted costs. One of the reasons we are here today is that electricity transmission doesn't face those sorts of market disciplines. Our long term objective is to find ways to introduce competition so that the electricity transmission is no longer a monopoly. Before that time arrives we want a regulatory regime that will mimic incentives and structures that might be expected in a market, eg establishing and promoting a balanced contractual framework.

The draft TPM and the associated draft BA and ICR have made little progress in shifting from the prior unilateral terms and conditions posted by Transpower to a more balanced contractual framework. I'll not elaborate on this further because the BA and ICR are subject to a parallel set of consultation; apart from noting that the approach of the EC in separating the process to establish contractual obligations and liabilities for defined transmission services from the process of deciding prices of those services at the outset hasn't helped.

Finalising an inaugural TPM and making a recommendation to the Minister that it be included as a schedule to the rules has material consequences on end consumers. Transmission services currently cost consumers over \$ ½ billion pa of which $\approx 2/3$ are interconnection related charges. How those might be re-allocated to end consumers is material. However the most important impact on consumers of the TPM is its influence on future investment in generation and transmission alternatives – and hence its impact on final delivered prices, not just the transmission component of those charges.

The sum of GUP and IGE proposals currently being considered or about to be proposed are in the order of \$2 billion and possibly \$3 billion plus. Investment decisions for generation of at least that amount have also been signaled by suppliers over the next 5 years. The importance of having the best TPM in place in the near term, that is over the next 5 years, in order that the most efficient mix of investment takes place cannot be understated.

The core of this debate that will affect the mix, location and timing of investment decisions is around the degree of locational pricing in the TPM. If we get the wrong TPM then New Zealand will end up with a suboptimal mix of generation and transmission that could cost the economy billions of dollars over the next 5 years compared to the case had the best possible TPM been gazetted.

The acid test of the TPM is whether the outcomes make sense. Cracks in the draft TPM appear to have already developed when applied to the proposed wind farm developments in the lower SI. To allow export from that region for a modest level of new wind generation might require interconnection upgrade costs of \approx \$30 million. For the larger wind farm proposals that have been suggested, in excess of \$200 million of new interconnection line assets will be needed. In the absence of these wind farm proposals those interconnection assets or upgrades are not needed. The draft TPM appears, from our analysis, to result in all consumers picking up those incremental interconnection asset costs. This outcome does not make sense.

If this outcome is repeated in other parts of NZ, and that looks highly likely, this will lead within the next 5 years to overbuild in interconnection assets, a subsidy to generators remote from load and overall higher delivered prices to consumers than had better locational pricing signals been given to those generators. This demonstrates that the draft TPM appears not to be fit-for-purpose in the one area that it's most critical; that is in ensuring efficient investment signals.

Another example of where the draft TPM fails is in the question of who should pay for the 400 kV capable line (but to be used at 220 kV for at least 20 years and possibly never converted to 400 kV) from Whakamaru to South Auckland and related works the EC have provisionally decide to approve. The NPV of the approved capital works, including property related costs, of \$450 million plus the NPV of subsequent future works, that is beyond the approval timeframe but work that was considered part of the GIT analysis justifying the 400 kV line decision of \$240 million. This gives a total of \$690 million of capital and property related works for the 400 kV line proposal. The draft TPM socialises these costs across all consumers throughout New Zealand. The draft TPM therefore leads to the outcome that manufacturers outside of Auckland will be paying a share of those 400 kV capital costs. This outcome doesn't make sense and hence the significant doubts we have about the draft TPM.

Promises that after gazetting an inaugural TPM the EC will come back and look at improving locational pricing signals with a future change to the TPM are not helpful. Changing the TPM will take at least 3 and probably more like 5 years. By then decisions on the bulk of the 4 billion dollars plus of proposed transmission and generation investment will have been decided on the basis of the draft TPM. The damage will have been done.

Fortunately NZIER have a solution, the "but for" approach.

I'll now hand over to Brent for a more detailed analysis of the draft TPM.

Ralph Matthes
Executive Director