

14 September 2020

Rebecca Osborne
Head of Grid Pricing Strategy
Transpower
By email to TPM@transpower.co.nz

Dear Rebecca

Consultation on Connection Charges

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Transpower paper "TPM Development: Connection Charges Consultation Paper" 24th August 2020.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Several members intend making submissions.
3. MEUG thanks the Transpower TPM team replying to various MEUG enquiries including a meeting with members. We appreciate the best practice adopted by Transpower of publishing answers to written questions by MEUG and other parties.
4. The consultation paper identifies in paragraph [5] focus area 8, First-mover disadvantage, as being the exception to the other focus areas where solutions to likely problems are for "moderate and incremental change." MEUG agrees and in addition considers focus area 7, Connection asset decommissioning costs, is already and in the future more likely to require "... a more material departure from current arrangements."

Focus area 1: TPM Code drafting tidy-up

5. No comment.

Focus area 2: Classification of assets during staged commissioning (Additional Component A)

6. MEUG agrees with Transpower that option 2 should be adopted (proposed new cl. 5(4)).

¹ Document URL https://www.transpower.co.nz/sites/default/files/plain-page/attachments/Connection_Charges_Consultation_Paper_and_Appendices.pdf found at <https://www.transpower.co.nz/industry/transmission-pricing-methodology-tpm/tpm-development-project-connection-charges>.

Focus area 3: The effect of other parties connecting to the grid (Additional Component B)

7. MEUG agrees with Transpower's proposed option 2.

Focus area 4: Regular updating of replacement cost building blocks

8. MEUG does not consider this needs to be embedded in the TPM. Transpower can provide certainty by giving sufficient notice to the market ahead of each update and involving interested parties in a consultation and feedback process on updated values for replacement cost building blocks. This behaviour is what we would expect of a reasonable and prudent asset owner and therefore need not be further codified.

Focus area 5: Introduction of cable line type for maintenance costs

9. MEUG supports Transpower's initial view that option 3 be adopted, i.e. Add a Cable line type and allow Transpower to estimate the maintenance recovery rate until there is a sufficient history of maintenance costs for connection asset Cables.

Focus area 6: Investment contract arrangements

10. MEUG supports Transpower's initial view that option 2 in conjunction with option 3 be adopted, i.e. to allow for partial capital contributions (option 1) and contributions to maintenance and operating costs under investment contracts.

Focus area 7: Connection asset decommissioning costs

11. This is a material issue because some large users' have announced either they will or have a review underway to consider closing or partly downsizing their business. The current direction of electricity and greenhouse gas policy settings will increase future power prices compared to lower cost scenarios suggested by the Interim Climate Change Committee. This will lead to more electricity intensive users' deciding to exit or downsize their business. Offsetting the decline in electricity intensive use by some businesses will be electrification of process heat loads by others. The connection points and the timing of large decreases and increases in demand are unlikely to be the same; hence issues on treatment of decommissioning connection assets may become more frequent.
12. For connection assets commissioned under Investment Contracts (i.e. outside the Commerce Commission Part 4 regulatory regime), decommissioning costs should either have been considered as part of those contracts or otherwise be the responsibility of Transpower. This could in some cases result in a windfall to Transpower if there is a resale value of the decommissioned assets that exceeds the cost of decommissioning or the reverse. This is not the status quo (option 1 in the consultation paper) where, as MEUG understands, Transpower assumes decommissioning costs for assets paid for by customers under an Investment Contract are socialised. MEUG's proposal is for a new option 4 where Transpower and customers agree if any provision for decommissioning should be included in an Investment Contract and if not then Transpower bears the net cost or benefit of decommissioning.

13. Option 4 precludes the consumer(s) that paid for the connection assets under an Investment Contract from having a claim on any net proceeds from sale of decommissioned assets. Without a contract, such a claim has no validity. Similarly, because Transpower has no contract with any counterparty as to how to treat decommissioning of Investment Contract connection assets, therefore Transpower should bear the net cost or bank the net windfall gain.
14. Going forward under option 4 Transpower and customers will have incentives to consider if future new Investment Contracts should have an explicit provision for decommissioning that could be usefully harnessed.
15. For connection assets approved by the Commerce Commission there are pros and cons for options 2 and 3, being to allocate decommissioning costs to all customers at the point of connection, or the exacerbator(s) that lead to the asset being decommissioned. For the latter option, the paper notes “If there are no contributing customers, the cost would be recovered through the residual charge.” Both options are arbitrary and some or all parties that end up paying for decommissioning costs received no private benefit when the asset had been in use. Our preference is Transpower should bear some or all the cost. However, until the Commerce Act Part 4 regime is changed, that option is not available. Therefore, the choice between these two poor options comes down to the deciding factor of using the largest denominator to socialise the cost. That is option 1, retain the status quo.
16. There is a supporting argument why connection asset decommissioning costs should be socialised as follows. Older connection asset operating, and maintenance costs will be higher than the asset fleet average. If that older asset is decommissioned earlier than its economic life, there is an incremental benefit to all other connected parties because average operating, and maintenance charges decrease. If the net present value of the share of that future incremental benefit to other parties at other points of connection is greater than the share of socialising the decommissioning of that asset, then there is no dis-benefit from socialising decommissioning of connection assets. It would be useful if Transpower undertook further analysis on the above effects and expected materiality of future decommissioning costs including:
 - The frequency decommissioning might occur in the future (i.e. to test MEUG’s view in paragraph [11] above).
 - The impact on Transpower’s economic return due to lower average operating, and maintenance costs due to early decommissioning of connection assets.

Focus area 8: First-mover disadvantage

17. For the free-rider problem (Type 1 Investment Contract connection charges problem) the generic solution of mimicking a market outcome where subsequent customers might have reached a reasonable agreement with the initial customer is supported. It is in the detail of the process and if appropriate, a codified formula, that determining a best one-size-fits-all solution is difficult. For example, MEUG does not consider the strawman proposal as representing all feasible outcomes that might occur in a workably competitive market as follows:
 - Assume consumer #01 agrees an Investment Contract for \$10m and pays that construction cost off in 5-years. Assume the asset has an economic life of 30-years and consumer #01 has, given it paid for the asset, rights to use the asset.
 - In a workably competitive market, another consumer or consumers that wished to start using that asset from any year one through to 30 would have to reach a commercial agreement(s) with consumer #01 and any subsequent consumers that had already reached agreement to share the asset.
18. The illustrative example in paragraph [106] of the consultation paper does not provide for other consumers to have a capital cost sharing mechanism with the first-mover, consumer #01 after year 6. Therefore, the proposal in the consultation paper is only a partial solution to the Type 1 Investment Contract free-rider problem. The free-rider problem still exists for any party that wishes to connect after year 6.
19. For the type 2 Investment Contract connections charges problem (over-building to meet Transpower's expectation of future growth) not all the feasible policy options have been considered. For example, Transpower could pay for the incremental over-build connection costs and take the risk that its expectations there will be demand growth will not eventuate. To allocate that risk to either the consumer entering the Investment Contract, other parties that may already be connected to that node or socialised across other counterparties to Transpower that may never benefit from the connection asset over-build are inferior options to Transpower bearing the risk of its expectations. If that means Transpower requires a different WACC from the Commerce Act Part 4 WACC then MEUG is open to commencing that discussion provided that is conducted as part of a broader consideration of how that risk fits with the current matrix of risks and incentives governing Transpower.
20. There are another two solutions to the type 2 problem:
 - First the first-mover may be prepared to pay for the overbuild because they expect the probability of a further consumer at that point of connection times the savings in connection charges with a subsequent consumer are worth them paying for it and taking the risk another consumer may not eventuate.
 - Second a potential future consumer may be prepared to pay an option to ensure capacity was available at a connection point and thereby avoid the risk capacity for their business would not be available in the future to take advantage of economies of scale now (otherwise they would have to pay for an entirely new connection asset).

21. Both these solutions utilise the strength of market participants making decisions rather than Transpower on the pros and cons of over-building at a connection point. Paragraph [113] of the consultation paper notes,

“Transpower operates an “open access grid” and does not reserve or guarantee future grid capacity to any customer. We consider that any future development of transmission capacity rights should be led by the Authority, not Transpower.”

MEUG agrees with this statement. However, that statement need not apply to connection contact capacity rights agreed under an Investment Contract.

22. There is an incentive on future free-riders to sit back and let Transpower either allocate costs to the first-mover or to every other grid user and therefore the free-rider gains both an option to connect and if it elects to do so, banks a subsidy for connecting. Transpower should do more work on how to unlock the commercial incentives on both first mover and future possible connected parties set out in paragraph [20] above to better mimic outcomes that would occur in workably competitive markets.

Concluding comments

23. We look forward to considering the submissions of other parties and if appropriate making cross-submissions.

Yours sincerely



Ralph Matthes
Executive Director