25 November 2020

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

Dear Rebecca

TPM: Prudent Discount Policy cross-submission

1. This is a cross-submission from the Major Electricity Users' Group (MEUG) on the views of fifteen other submitters lodged by 18th November on Transpower's consultation paper "TPM Development, Prudent Discount Policy Consultation" published 28th October 2020[1].

2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Members may lodge separate submissions.

Focus area 1: Approach to Stand Alone Cost Prudent Discount (SACPD)

3. In addition to the submission MEUG made on 18th November on focus area 1, we acknowledge the point by Counties Power that overhead costs for a stand-alone SACPD proposal (the factual) will need to be carefully considered as they will not have the benefit of economies of scale when comparing with the status quo (the counterfactual).

Focus area 2: Process and administrative changes

4. MEUG has no changes to the submission made on 18th November on focus area 2.

Focus area 3: Analytical and commercial changes

5. MEUG has one change to the submission made on 18th November on focus area 3. That is on the discount rate for the tests for commercial viability and efficiency. MEUG submit:

    a) No change in our earlier support that the discount rate to test SACPD proposals should be Transpower's regulated WACC. This is not a trivial estimation as the regulated WACC published by the Commerce Commission have at most a 5-year forecast horizon. To forecast a 15-year WACC will require judgement on

[1] https://www.transpower.co.nz/sites/default/files/uncontrolled_docs/All%20PDP%20submissions%20received.pdf contains all submissions, at web site https://www.transpower.co.nz/industry/transmission-pricing-methodology-tpm/tpm-development-project-prudent-discount-policy

parameters such as the risk-free rate relevant for a 15-year investment, whereas others such as asset beta and market risk premium will be constant.

b) Previously we agreed with the consultation paper proposal that the customers WACC be used for testing IBPD proposals.

This is straight forward if the IBPD applicant is a generator. As the consultation paper noted for the existing discounts for Waipori and Matahina/Aniwhenua, the WACC used was that of a generator and a generic generation sector asset beta can be estimated using beta observed of worldwide listed generators.

If the customer were a direct connect then the question is what is the appropriate WACC? MEUG considers the appropriate WACC is also a representative generator WACC. That is because the customer in considering the economics of alternative projects for acquiring electricity for their business would consider:

- Existing transmission assets to transport power from remote dedicated generation or the wholesale market pool; or
- The IPBD proposal to transport power from the wholesale market pool; or
- Building generation onsite to avoid any transmission costs.

What matters to the customer is finding the lowest cost net present value project for all feasible options, subject to normalising for an equivalent utility the customer demands when they weigh cost (price) and power quality for each option. The appropriate risk-weighted (asset beta) opportunity cost to the customer for assessing these competing generation projects to deliver power is a generation WACC. Hence the appropriate WACC for IBPD proposals whether they are from load or generation, is a generation sector WACC.

Focus area 4: Funding prudent discount

6. MEUG has no changes to the submission made on 18th November on focus area 4, i.e.

 a) option 1, allocate first to other beneficiaries of the assets to be discounted provided do not exceed the point that their net private benefit is no longer positive; then

 b) for any balance option 3, allocate across all customers except those already allocated a share in option 1 that have no remaining net private benefits.

7. Other submitters had a wide range of views. All five suppliers that made submissions and one consumer, Refining NZ, supported the initial thinking of Transpower in the consultation paper for Option 2, recovery through the residual.

8. Most EDB supported option 3. The Electricity Networks Association (ENA) suggested increasing the base to spread the discount by including grid-injection connection charges. We are unsure why ENA did not consider load connection charges. In any case, MEUG does not support that suggestion because connection charges, be they grid-injection or load-offtake, are already the most market-like of charges and including a discount “adder” would distort those charges.

9. PowerNet saw pros and cons with both option 1 and 2 and recommended "... net-benefit analysis is undertaken to assess the respective costs associated with implementation of option 1 and option 2 before a final decision is made." A cost-benefit-analysis may be helpful though we think the TPM Guidelines give sufficient clarity in support of option 1 as the best allocator of prudent discounts.

10. An excellent argument in support of option 1 was provided by Unison and Centralines:

> "Unison does not support recovery of revenue shortfalls by way of residual charges for benefit-based investments (BBI), as it detracts from the principle that the beneficiaries of transmission investments should pay for that investment. The corollary of BBI and BBC is that nonbeneficiaries do not pay for the investment. Given the generally significant consumer surplus of electricity use compared to costs, it would be unlikely that redistributing the revenue shortfall due to prudent discounts among remaining beneficiaries of a BBI would cause costs to exceed benefits. Accordingly, Unison submits that revenue short-falls from prudent discounts to benefit-based charges should, in the first instance, be allocated to remaining beneficiaries. If a cost-benefit assessment determines that charges exceed benefits to remaining beneficiaries, then only the amount necessary to equate costs and benefits should be allocated to the residual charge. While we recognise that it adds complexity to the process of reallocating the revenue shortfall, Unison submits that as far as possible Transpower should adhere to the beneficiaries-pay principle underpinning the new TPM."

11. The only difference between the Unison and Centralines submission with MEUG is any balance to be recovered after option 1 (from benefit-based charges) is:

    a) From the residual (option 2) according to Unison and Centralines though there is no rationale why option 3 is not considered; and

    b) From all customers according to MEUG with our rationale for choosing option 3 over option 2 set out in our earlier submission.

Yours sincerely

Ralph Matthes
Executive Director