18 November 2020

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

Dear Rebecca

TPM: Prudent Discount Policy

1. This is a submission from the Major Electricity Users' Group (MEUG) 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.

3. The views in this submission may change after we have considered the views of other submitters. References in parenthesis to "Qu." refer to the questions, and numbers in square brackets refer to paragraph numbers in the consultation paper.

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

4. MEUG agrees with the proposal to use a brownfields approach (Qu. 1.1) and using a principles-based and non-prescriptive approach (Qu. 1.2).

5. Comments on other aspects of Transpower's initial thinking for SACPDs (Qu 1.3) follow:

   a) The proposed 15- year term [41]. Having a standard term will provide certainty to applicants and lower administrative costs for processing applications compared to leaving the term open for negotiation. There is one aspect of the term of a SACPD that is unclear. That is how expected future major maintenance or capital replacement for the assets being bypassed would be treated in the factual (the proposed SACPD brownfields alternative) and the counterfactual (what is expected to happen with the existing assets, i.e. the "do nothing" scenario). MEUG suggests Transpower publish a worked example to illustrate how expected future major maintenance or capital replacement would be treated.

[1] Document URL https://www.transpower.co.nz/sites/default/files/uncontrolled_docs/TPM%20Development%20Prudent%20Discount%20Policy%20Consultation.pdf at https://www.transpower.co.nz/industry/transmission-pricing-methodology-tpm/tpm-development-project-prudent-discount-policy

b) The quality of energy supplied by a SACPD is equivalent to the existing assets [38]. MEUG does not consider this to be a trivial aspect of a SACPD application and could be prone to uncertainty and dispute. More clarity is needed. For example, MEUG suggests what matters is the quality of supply expected to be demanded in the future by the end user of the transmission service and not the historic quality of supply provided by Transpower. For a SACPD application the forecast quality of supply demanded by a transmission user in the counterfactual, may differ from the past because the user may change their demand profile with the new TPM that comes into effect April 2023 and other changes in the market such as the commencement of Real-Time-Pricing in October 2022. Similarly, for the factual, that is a brownfields bypass SACPD proposal, costs and service quality may differ and the customer may adapt their demand accordingly leading to a higher NPV of future net benefits than the counterfactual.

Focus area 2: Process and administrative changes

6. This covers both SACPDs and inefficient bypass prudent discounts (IBPDs). MEUG:

a) Assumes the discussion on application fees refers only to SACPDs. i.e. the status quo of no application fee applies for IBPDs. We agree SACPD applicants should pay reasonable costs incurred by Transpower to process an application. The $100,000 quoted in paragraph [49] is an EA estimate for the purposes of its cost-benefit-analysis when considering changes to the TPM Guidelines. Transpower should make its own more detailed estimate in case the EA estimate is materially over or under-estimated and advise the market. If the cost of processing an application depends on the specifics of the SACPD application, then a one-size-fits-all $100,000 minimum fee is not reasonable. This again supports our view Transpower needs to consider in more detail how it would process and what the costs of processing a SACPD application would be. MEUG agrees a part-payment on lodgement would be appropriate and there would be no refund of fees for unsuccessful applications. There should be provision to settle any dispute between the applicant and Transpower on the final fee for reasonable application costs, whether that fee is on an ex post actual basis of an ex ante agreed fixed fee.

b) The independent verification proposals ([58] to [59]) mimic the successful application of independent verifiers by the Commerce Commission in regulating Transpower and EDB under Part 4 of the Commerce Act. MEUG suggests the scale of the verifiers task in the Part 4 regime is at least an order of magnitude greater, in terms of value, than the likely scale of an application relative to Transpower's annual revenue path. In that case there may be other options that give confidence to Transpower on the robustness of an application such as the applicant engaging engineering and other advice from a panel of advisors pre-approved by Transpower. A consultant from that pre-approved panel would in effect self-verify saving the cost to an applicant of employing independent advisors and separately pay for a verifier.

c) Agrees with the suggested approach to publication and consultation ([60] to [63]) with three additions:

i) There is a two-step process for applications with the first step allowing the application details to be kept confidential and only once the application proceeds to the second step are details published. The market should be notified of the application to the first step but not the details. If in the first step the applicant decides to withdraw then the application is not published. The applicant should pay all reasonable Transpower costs to process the application up to step 2 even if the application is withdrawn. The application fee breakpoint between step 1 and step 2 could be the up-front part-payment discussed in [51] and paragraph 6 a) of this submission.

Giving applicants a veil of confidentiality at the initial stages of Transpower considering an application will give both parties an opportunity to identify any fundamental problems with the application and assist an applicant withdraw without third parties expending resources pointing out the same if Transpower simply published an application once received. There may also be an opportunity for Transpower and the applicant to bi-laterally agree changes to the application before it is published. In that case if the applicant decided to proceed to stage 2 the agreed changes with Transpower should be published so it is transparent what changes were made.

ii) When Transpower publishes a decision approving an application, that decision should include a table listing the Transpower customers that will pay a share of the re-allocated discount costs and the value in dollars for the first year it applies applicable to each of those customers.

Requiring Transpower to publish the share of costs for all other customers will allow scrutiny of the final decision by customers and incentivise Transpower in processing applications to estimate these values for inclusion in consultation with interested parties.

iii) At the start of each pricing year when Transpower advises each customer of its charges for that year, the list of charges have separate line items for every share of the re-allocated discount costs for every prudent discount given to other customers. This suggestion is consistent with clause 6 of the TPM Guidelines.

Continuous annual disclosure to customers of their share of prudent discounts given to other customers will facilitate their deciding whether to take an active interest in future applications that might add costs to their transmission costs. The points in sub-paragraphs 6 c) ii) and iii) above align with clause 6 of the TPM Guidelines

Focus area 3: Analytical and commercial changes

7. The initial thinking of Transpower on treatment of electrical losses, treatment of benefiting customers, discount rate for present value calculations, commercial viability test, good electricity industry practice criterion, levelised annuity, and conditional approvals and terminations are (Qu. 3.1) not-contentious subject to MEUG considering other submitter views.

8. MEUG suggests a change from Transpower's initial thinking on commencement of a prudent discount agreement (Qu. 3.3). We understand the need for a minimum 6-month lead time between commencement of a prudent discount agreement and a pricing year in [81]. Missing is a requirement on Transpower to process an application within a certain timeframe. Applicants have no certainty an application will be processed promptly and Transpower has no incentive to do so. A maximum time between the date an application is lodged and when a decision must be made should be specified. A fixed timeframe is used, for example, for the Commerce Commission to process Customised Price-Quality Path applications. To avoid Transpower being unable to meet a fixed deadline if multiple applications are received with over-lapping processing times, a waiting queue or other formula to extend timeframes should be specified. Timeframes may differ for IBPDs and SACPDs if Transpower expects the time needed to process those will differ.

Focus area 4: Funding prudent discount

9. The intent of the TPM guidelines is to migrate transmission charges over time to be benefit-based charges (BBC). Connection charges are already BBC. The expectation is that over time residual charges will decline. The treatment of who pays for a prudent discount should consider this longer-term expected outcome. On that basis MEUG views option 2, full recovery through residual charge, as the status quo rather than aligning with the longer-term desired trend, and therefore option 2 is less desirable than option 1 or 3.

10. Option 3, recovery from all customers, is appealing because it spreads the cost across as wide a base as possible within the constraints of the TPM. However, this only applies if these costs were truly "tax-like", that is a pure revenue appropriation by government with no paired benefit-stream. In that case the asset confers no benefit to any other customer and in a workably competitive market setting would be written off to the account of the asset shareholder. That option needs to be considered within the jurisdiction of the Commerce Commission as it is outside the remit of the TPM governed by the Electricity Authority. Nevertheless, the principle of allocating tax-like costs (such as costs associated with assets that confer no benefit) to as wide a "tax-base" as possible is relevant.

11. If the transmission assets that a prudent discount applies, do confer benefits to other customers apart from the prudent discount applicant, then those other beneficiaries can be charged higher BBC to recover the costs of the discount for those assets provided they still receive a positive net private benefit. This is option 1, full or partial recovery through BBC. If increasing BBC for remaining beneficiaries reaches the point where net private benefits start to turn negative, then the balance of the value of the discount to be recovered could be either by option 2 or 3.

12. Following on from the discussion in the preceding three paragraphs, and the submission on transparency in paragraph 6, MEUG's preference for recovery of prudent discounts is (Qu. 4.1):

   a) Option 1, full or partial recovery through BBC to the point that net private benefits cease to be positive.

   b) The balance to be recovered using option 3, recovery from all customers, excluding customers in the region that a prudent discount has been granted as those customers in step a) above will have already reached the point where their net private benefits cease to be positive.

      A consequence of this is that the calculation of the effect on net private benefits in a region where a prudent discount application is being considered will require sufficient granularity to distinguish between different classes of consumers with different future demand profiles for transmission services.

   c) Transparency by Transpower when publishing approval for a prudent discount application and each year on every customers' annual pricing advice as proposed in paragraphs 6 c) ii) and iii) above.

Yours sincerely

Ralph Matthes
Executive Director