



MAJOR ELECTRICITY USERS' GROUP

26 September 2017

Nicki Sutherland
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Transpower
By email to nicki.sutherland@transpower.co.nz

Dear Nicki

Draft Transpower Works Agreement

1. This is the Major Electricity Users' Group (MEUG) feedback on Transpower's draft Transpower Works Agreement (TWA) and explanatory consultation paper emailed to Transpower customers and interested parties on 5 September 2017.
2. MEUG members have been consulted in the preparation of this feedback. This feedback is not confidential. Some members may make separate comments.
3. This feedback comprises first a comment on the change to the Finance Rate (paragraph 4). Second questions on other aspects of the TWA (paragraph 5). It may be efficient to work through those questions in a discussion with MEUG members.
4. MEUG welcomes the change to use a finance rate, for the payment plan option, equal to the regulated WACC rather than an increased rate as proposed in draft consulted on early last year.¹ We agree with the explanatory paper that "the decision not to apply an increased finance rate is a significant change since the last version."²
5. MEUG has four questions:
 - a) The Finance Rate is the regulated vanilla WACC used for the IPP at the time the TWA applies.³ The regulated WACC is the WACC at the 67th percentile rather than the mid-point. The uplift between the mid-point and 67th percentile reflects the Commerce Commission's view it is better to bias the WACC to avoid under-investment by regulated line service providers in long-lived assets with economic lives beyond the usual 5-year price-quality and no more than 7-year input methodology resets given uncertainty in estimating WACC.

¹ MEUG's agreement to use of the regulated WACC is subject to clarification on question in paragraph 5 a) of this submission.

² Explanatory paper, p3.

³ Schedule 7, paragraph 1.2

Those risks do not apply to customer specific works built in terms of the TWA where there is no ambiguity on whether Transpower should invest as it will not do so without a customer signing a TWA and there is surety to Transpower of recovering costs. We would like to discuss the proposition that in the case of TWA the appropriate WACC is at most the mid-point.

- b) Can Transpower provide a rationale and evidence for the proposed Administration Fee Rate of 2%? The Administration Fee Rate multiplied by the Net Total Cost equals the Administration Fee.⁴ We are interested, for example, in exploring:
- i) Why 2% was used compared to a higher or lower rate with relevance to project size?
 - ii) Should the rate change for scale of the project and or number of TWA being managed and or expected ongoing efficiency improvements by Transpower including efficiency improvements in administration costs?

To illustrate the first of these we are interested in discussing whether administration costs would change in proportion to capital cost for two works that are identical and provide the same service for customers apart from one being an order of magnitude larger and costlier? For example, a 2% Administration Fee Rate on a \$1m work project equals an Administration Fee of \$20,000 whereas a 2% Fee on a \$10m work project has a Fee of \$200,000. Is it true administration costs would be 10 times higher for the larger project or should there be a cap or a sliding scale used for the Fee Rate?
 - iii) In estimating the proposed 2% Administration Fee Rate how are the following taken into consideration?
 - Are any direct internal costs (including staff time) capitalised?
 - Are any indirect costs (eg administration) capitalised?
 - For staff time, is the “charge” at net salary or some multiplier?
 - At what point in the pre-engineering and customer negotiation process do costs start to be capitalised?
- c) The early termination charge includes several variables that are estimated at Transpower’s discretion: R, CF_{adj}, DC, AU, DR, AR and k.⁵ That discretion would be subject to the obligation for Transpower to act “reasonably, in good faith, and accordance with Law”.⁶

Missing from the list of obligations for estimating these charges is “Good Engineering Practice” (GEP). Potentially GEP should be a guide to Transpower’s conduct for estimating some of the above variables and hence should the obligation to use GEP for estimating values for early termination be included in cl. 2.1(b)?

This change would then align with the paragraph under the header “Transpower obligations” on p2 of the explanatory paper:

“Clause 2 requires Transpower to act reasonably, in good faith and in accordance with Good Engineering Practice. This applies to all Transpower decisions and actions under the Agreement, including asset repair and replacement, setting and changing budgets and timeframes, and calculating cost.”

⁴ Schedule 7, paragraph 1.1.

⁵ Schedule 7, paragraph 5.2.

⁶ cl. 2.1 (c).

- d) The early termination charge nets off half of Transpower's estimate of any revenue Transpower expects to derive from the disposal of any part of the Works.⁷ Can we discuss why 50% is used as opposed to 100% or some other percentage?
6. As mentioned in paragraph 3 we think it might be efficient to work through the above questions and any other questions members may have in a meeting.
7. The TWA is a template that will have a range of counterparties, that is distributors, generators and grid connected customers, and they will have different areas of focus and views. The TWA will also, in our view, be relevant and set precedents for how EDB contract for works they undertake for their customers. Because of the wide industry interest in the TWA MEUG suggest Transpower facilitate discussion with and by all parties by publishing all submissions and allowing cross-submissions and or facilitating a workshop to discuss feedback.
8. We are keen to assist Transpower achieve operation of this important template agreement by either end of the year or early next year. We agree with and think that this agreement will achieve Transpower's objectives to make such agreements more effective and equitable.⁸ The latest draft TWA is a significant step towards achieving those goals and we look forward to carrying on with the constructive discussions to date with Transpower and other sector participants.

Yours sincerely



Ralph Matthes
Executive Director

⁷ Schedule 7, paragraph 5.2, the term "DR/2" in the formula of ETC_a.

⁸ Explanatory paper, opening paragraph.