

1 October 2013

Fraser Clark  
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Wellington

By email: [submissions@ea.govt.nz](mailto:submissions@ea.govt.nz)

Dear Fraser

## **Draft decision: NAaN asset classification under the TPM**

Thank you for the opportunity to comment on the consultation paper, *Draft decision on exemption application – classification of NAaN assets under the TPM*, published by the Electricity Authority (The Authority) on 17 September 2013. Our interest in this matter is as grid owner, and as transmission pricing administrator.

### **Support consultation before making a decision**

We understand that the Authority has departed from its usual practice by consulting on an exemption decision, and appreciate the opportunity that this provides to correct the Authority's initial thinking.

The decision to consult is particularly welcome because, at a substantive level, the draft decision is incorrect. This submission:

- clarifies the factual situation, which the Authority has misunderstood; and
- tests the Authority's assessment of the exemption against the requirements of section 11(2) of the Act.

The draft decision would run counter to the Authority's statutory objective by causing and driving a price shock into the Auckland region, imposing unexpected costs on Vector and Auckland retailers and consumers, and discouraging efficient operation and development of national grid. These outcomes are *not* in the long-term interest of consumers. The reasoning that has led the Authority to its draft decision is surprising and, in our view, reduces confidence in the predictability of the Authority's regulatory decision-making. This is also not in the long-term interest of consumers.

As TPM administrator we pursued an exemption so that our customers could be assured we had adopted a transparent and robust approach to departing from a patently perverse outcome. In our view there is no doubt that approving the exemption is appropriate, and we are disappointed the Authority has complicated what should be a straightforward decision.

### **A fundamental misunderstanding of the facts and situation**

The draft decision rests on incorrect assumptions. We correct these below:

1. Staged commissioning was in everyone's interest

Staged commissioning has brought benefits for all New Zealanders, and is broadly cost neutral. Once it became apparent that the southern sections would be delayed, it was better to press ahead and commission the northern sections than to leave them idle or to slow down their completion. Bringing the cables into service protects their condition, mitigates commissioning risks, increases reliability for parts of Auckland (an important part of the New Zealand economy) and reduces losses (to the benefit of all electricity consumers). It also allows project financing costs to cease, reducing the commissioned cost of the project (again, to the benefit of all consumers).

2. Granting the exemption does not leave Vector with no costs

If the exemption is granted, Vector still funds approximately 25% of the cost of the cables (via interconnection charges) and substantially all of the costs of the Wairau Road and Hobson Street substations (via customer investment contracts, or CICs). The CICs alone fund \$73 million of assets.

**Section 11(2) assessment is flawed**

To decline the exemption, the Authority has to be sure that it is necessary for the purpose of achieving its statutory objective that the cables be classified as connection assets. We cannot see how this can be the case given the facts.

It is clear that the TPM simply did not contemplate that interconnection assets may transition through a phase during construction where, for a short period of time, they appear to be configured as connection assets. This situation has, to our knowledge, not arisen before and is unlikely to arise again. Treating the cables as connection assets in this one-off situation does nothing to help achieve the Authority's statutory objective. It simply pushes unexpected costs onto Vector and into the Auckland market. This can only undermine confidence amongst electricity market participants and end consumers. Even if a similar scenario were to arise again, the Authority's draft decision would have the effect of deterring efficient commissioning practices.

Rather than follow the logic above, the Authority has looked to its 2012 paper 'Decision-making and economic framework for transmission pricing review' as a tool to help it assess the exemption application. This is entirely unhelpful:

- the Authority developed the framework to help identify pricing options as part of its ongoing pricing review process. The framework was not well supported by submitters and, in any case, does not have any particular relevance to considering whether to grant an exemption relating to the *current* TPM
- applying the framework has introduced a number of theoretical, but largely irrelevant, considerations into the decision-making process
- using the framework in this way runs counter to predictable, stable administration of the Code.

Applying the framework has 'muddied the waters' and led the Authority to turn its mind to considerations that are not relevant to the exemption decision. In particular, the Authority has concerned itself with the overall timing of the NAaN project, and with assessment of the beneficiaries of the NAaN project. While we consider these matters irrelevant to consideration of the exemption, we nonetheless note the following.



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- The exemption has *no bearing* on the overall timing of the project. The decision to move to staged commissioning was made due to delays on the southern sections after the project was committed and well underway.
- Vector *does* bear timing risk. As noted earlier, Vector has CICs for Hobson Street and Wairau Road substations for around \$73 million of assets. Vector also funds approximately one quarter of the interconnection charge.
- It is misleading to compare *ex post* prudent peak forecasts with *ex ante* actual demand and conclude a project was committed too early. Actual demand should turn out lower than the prudent peak forecast nine times out of ten. This reflects that demand growth is uncertain and the costs of being too late are higher than the costs of being too early.
- It is wrong to conclude that consumers outside Auckland do not gain any benefit from staged commissioning of the cables. They enjoy the benefits of lower electricity demand from Auckland (due to reduced losses), increased reliability in a key economic centre, lower overall project costs, assets in better condition, and less commissioning risk on the power system. In addition, granting the exemption would be more consistent with stable, predictable regulation of transmission prices.

We also note there is an inference in the paper that Transpower elected to treat the northern cables as interconnection assets when setting the interconnection rate for the 2013/14 pricing year. This is not the case. Inclusion of the NAaN assets in the interconnection rate is simply a normal consequence of the timing involved in the MAR setting and TPM charge-setting processes. Any asset that is forecast to be commissioned but is not visible to the pricing system at the time assets are allocated is, by default, captured within the interconnection charge.

### **The Authority should grant the exemption**

Declining the exemption application would create unexpected costs for Vector, and for Auckland retailers and consumers. There is no off-setting benefit. On the contrary, declining the exemption would heighten perceptions of unpredictable regulatory decision-making and would deter efficient practices should a similar situation ever arise in future.

The exemption simply seeks to avoid a perverse and costly outcome that arises because the TPM does not anticipated staged commissioning of interconnection assets. Allowing this perverse outcome to occur is not necessary for the purposes of the Authority's statutory objective, so the Authority should grant the exemption.

If you have any questions about our submission please contact me on 04 590 6862.

Yours sincerely

Ross Parry  
**Planning and Regulatory Manager**

## Appendix A – Responses to Consultation Questions

Question No.	Question	Response
1	Do you consider that the proposed decision to decline the exemption is correct? If not, please describe why you consider the exemption should be approved.	<p>No.</p> <p>To decline the exemption, the Authority has to be sure that it is necessary for the purpose of achieving its statutory objective that the cables be classified as connection assets. We cannot see how this can be the case given the facts.</p> <p>It is clear that the TPM simply did not contemplate that interconnection assets may transition through a phase during construction where, for a short period of time, they appear to be configured as connection assets. This situation has, to our knowledge, not arisen before and is unlikely to arise again. Treating the cables as connection assets in this one-off situation does nothing to help achieve the Authority's statutory objective. It simply pushes unexpected costs onto Vector and into the Auckland market. This can only undermine confidence amongst electricity market participants and end consumers. Even if a similar scenario were to arise again, the Authority's draft decision would have the effect of deterring efficient commissioning practices</p>
2	Is there additional information that the Authority should have considered when making its decision, or errors of fact in the material presented in this paper, that may have affected the Authority's decision making? If yes, please provide the additional or corrected information.	<p>Yes.</p> <p>The Authority does not seem to have appreciated that, even if the exemption is granted, Vector will fund approximately a quarter of the costs of the cables and substantially all of the costs of the Wairau Road and Hobson Street substations.</p> <p>The Authority does not seem to have appreciated that staged commissioning is broadly cost neutral to all consumers (given it allows early termination of project financing costs) and clearly beneficial to all consumers (due to reduced losses, increased security of supply into a key part of the economy, and reduced commissioning risks).</p> <p>It is not true that Vector bears no timing risk, that only Vector benefits from the commissioning approach, or that no other parties benefit.</p>

Question No.	Question	Response
3	Do you agree with the approach the Authority has taken to considering this exemption application against the requirements for granting exemptions in Section 11(2) of the Act? If not, what approach do you consider should have been taken?	<p>No.</p> <p>It is entirely unhelpful to apply the 2012 paper 'Decision-making and economic framework for transmission pricing review' as a tool to help assess the exemption application. This has 'muddied the waters' by introducing irrelevant considerations. This approach undermines confidence in predictable regulatory decision-making.</p> <p>The Authority should simply consider the straightforward question of whether it is necessary for the purpose of achieving its statutory objective that the cables be classified as connection assets. We cannot see how this can be the case given the facts (refer Q1).</p>