



TRANSPOWER

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Carl Hanson
 Electricity Authority
 Wellington

By email: submissions@ea.govt.nz

Dear Carl

Transmission Pricing Methodology Review Cross-Submission

Thank you for the opportunity to cross-submit on submissions to the Authority's consultation paper *Transmission Pricing Methodology Review – issues and proposal*.

There is a clear and consistent message in the submissions that further work is required before suitable guidelines can be issued. It is also clear from many submitters that the status quo for interconnection charging (aside from perhaps the HVDC charge) is preferred over the proposed use of the SPD method. Any further consultation should be on options to refine the existing arrangements, rather than on revisions to the original proposal.

Our cross submission is limited to reiterating how the current connection charging arrangements work as there was some confusion evident both in the proposal and submissions.

Connection charging framework

The majority of submissions from our connection customers agreed there is no material problem with the connection charging framework, and connection charging was not a focus for most submitters with no strong endorsement for change.

However, some of the submissions that agreed there were no material problems also agreed with the proposed change away from a pool-based approach to connection charging. Given this confusion we have set out key aspects of how the existing framework operates

Capital and depreciation charges for customer assets may be recovered under the transmission pricing methodology (**TPM**) or via a connection investment contract (**CIC**).

The TPM uses a 'pool-based' approach, where asset charges for all connection assets are 'pooled' and allocated across all connection assets. The allocation of connection asset charges is based on the formula below.

$$A_{conn} = (WACC \times RAV_{conn} + D_{conn}) \frac{RC_{conn}}{\sum RC_{conn}}$$

Where:

A_{conn} = the asset component of a connection charge
 $WACC$ = Transpower's regulatory WACC

RAV_{conn} = regulatory asset value of all connection assets
 D_{conn} = total annual depreciation of all connection assets
 RC_{conn} = replacement cost of connection assets

Key points are:

- connection charges are based on the regulatory asset value of connection assets, so they recover the full capital-related costs of those assets. There is no 'excess' recovered through interconnection charges
- replacement costs are only used to allocate the capital-related costs of the connection pool. There is no relationship between the replacement cost values used and the overall level of connection charges.

These points mean that:

- there is not a problem in practice with parties trying to shift costs to the interconnection pool by seeking TPM-based charging in preference to CIC-based charging
- updating the replacement cost values would not achieve any improvement to the efficiency of connection charges but could alter the allocation of charges between customers reflecting the *relative* movements in the replacement costs of different asset types.

There are significant advantages to this pooling approach for existing connection assets. The customer is effectively charged for the service received, and Transpower can make decisions as to how best to maintain that service. This assists us to optimise capital expenditure for renewal across the grid and avoids our customers experiencing price shocks due to routine asset replacements,

In contrast to TPM connection charges, CIC charges allocate the costs of specific assets covered by a CIC to the contract counterparty. We use CICs predominately for new connections or material expansion of existing services, and customers thus see the cost of providing that additional service. CIC charges provide flexibility for customers to negotiate the charging profile, including the duration of the contract and the balance between annualised and lump-sum components. CICs have a charge profile that is flat in nominal terms (i.e. declining in real terms).

As described in our original submission, the proposed changes would be much less effective than the status quo. We would be pleased to discuss connection charging arrangements further to assist the Authority.

Yours sincerely



Ross Parry
Planning and Regulatory Manager