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TRANSPOWER IPP TPM DEVELOPMENT EXPENDITURE ALLOWANCES CHANGE CONSULTATION

1. Introduction

1.1.1. Trustpower Limited (**Trustpower**) thanks the Commerce Commission (**Commission)** for the opportunity to submit on its 14 September 2021 draft decision on a *Reconsideration of Transpower's individual price-quality path (**IPP**) determination in response to the Electricity Authority decision on Transmission Prciing Methodology Guidelines- proposed changes to 2020-21 expenditure allowances for the cost of TPM development* (**draft decision**).

1.1.2. This submission comments on the request the Commission has received from the Electricity Authority (**Authority**) to reconsider Transpower's IPP determination to take into account the TPM Guidelines.

1.1.3. However, for the record, we have no issue with the Commission's other proposed amendment to correct a drafting error in the definitions of 'actual transmission revenue' and 'other regulated income' to ensure the wash-up calculation required under clause 9 of the Transpower IPP determination can be calculated correctly.

1.1.4. Our views on the additional expenditure allowance issue are set out below.

2. Context for additional expenditure allowance

2.1.1. The Authority published new TPM Guidelines in June 2020. The guidelines require fundamental changes to the current methodology for allocating Transpower's regulated revenues amongst distributors, grid connected load and generators.

2.1.2. These changes include the replacement of the current interconnection and HVDC charges with new benefit-based and residual charges, the introduction of a second form of prudent discount, and a bespoke price cap.

2.1.3. The benefit-based charge involves complex modelling as it seeks to assess the lifetime net private benefits of individual transmission assets within the interconnected grid. There are four different methods for determining net private benefits for different types of transmission assets in the proposed TPM each of which has a different calculation methodology.

2.1.4. The complexity extends beyond the assessment of benefits: for example there are 17 different events which could result in adjustments to the benefits-based charges and a highly bespoke and unusual new prudent discount policy.

2.1.5. Transpower sought more time for the development of the TPM and engagement with its customers due to the complexity of the task it was given. The Authority did not think that more time was necessary.

3. Expected size of additional expenditure allowances

3.1.1. In the period from June 2020 to June 2024, Transpower forecasts TPM development, establishment and systems opex of $16.7 million and systems capex of $10.7 million to implement these new guidelines.

3.1.2. This is a significant, up front cost for tariff redesign.

4. Expected benefits to consumers of this reform

4.1.1. The Authority is expecting net benefits of $1.3 billion as a result of these reforms to the TPM[1].

4.1.2. Most of the quantified benefits ($1.1 billion) arise from:

a) the Authority's assessment of the value of consumers having increased electricity use during peak demand periods (as its proposal removes the regional coincident peak demand charge); and
b) the Authority's expectation that the *extra generation* required to serve this increase of demand will be delivered at a *lower wholesale electricity prices* than the base line (the increase of demand is only about 1% as in the Authority's modelling there is a shift in time of use rather than step change in underlying demand).

4.1.3. If the Authority's expectations are robust, then this makes the approval decision for this additional expenditure allowance very easy, and the Commission need not be overly concerned about the size of Transpower's additional expenditure request.

4.1.4. Expenditure of $27.4 million to deliver benefits to consumers of $1.3 billion by any measure is 'a good deal'.

5. Trustpower's views on expected benefits

5.1.1. Unfortunately, Trustpower does not consider that these consumer benefits will ever arise.

5.1.2. The Authority's analysis shows that the change in *the cost of producing electricity* to meet the increased electricity use over the modelling period is an increase of $5 million. Our view is that it is not credible to claim that an additional $5 million generation costs will result in a benefit of $1.3 billion.

5.1.3. Our experts have advised that:

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[1] A summary analysis of the Authority's cost benefit analysis results can be found on page 92 of its Transmission pricing methodology 2020 Guidelines and process for development of a proposed TPM decision 10 June 2020 https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/transmission-pricing-review/development/tpm-decision-and-guidelines/

a) the Authority's cost benefit analysis has fundamental errors; and
b) the Authority has also made a number of errors of law in its decision to adopt and publish the new TPM Guidelines.

5.1.4. As a consequence of this advice we are seeking a review of the Authority's decision-making on the TPM Guidelines in the High Court.

6. Legal framework for this draft decision

6.1.1. We note the Commission must reconsider a section 52P determination (such as Transpower's IPP) if requested to do so by the Authority.[2]

6.1.2. It must also take into account any relevant guidelines issued by the Authority.[3]

6.1.3. However the Commission has discretion as to:

a) whether it is necessary or desirable to amend Transpower's price path; and
b) the level of expenditure it should allow in any such amendment.

6.1.4. We note the Authority has not expressed any views on the prudent level for Transpower's TPM development costs.

7. Exercise of discretion

7.1.1. Transpower's submissions over the course of this reform show that it has serious reservations about the need for and workability of the new TPM Guidelines. Its notable that Transpower's economic expert formed a similar view on the Authority's 2019 cost benefit analysis to that of our expert.

7.1.2. However, Transpower has always acknowledged that it is obliged under the Code to develop a TPM which conforms to the guidelines.

7.1.3. In the circumstances we think the Commission should exercise its discretion to allow for the recovery of Transpower's prudent TPM development costs. Regulated suppliers should be able to recover prudent costs caused by another regulator's decision-making.

7.1.4. This leaves the issue of prudency in relation to both the timing and level of any additional expenditure allowance.

8. Staged approach to additional expenditure allowance

8.1.1. The draft decision acknowledges the challenges associated with obtaining accurate forecasts of accuracy of the TPM development costs for remaining disclosure years of the current price path.

8.1.2. If Trustpower's court action is successful it is possible that the TPM Guidelines will be set aside.

8.1.3. The Authority may itself also decide to change elements of this reform following consultation on the TPM developed by Transpower to comply with the new TPM Guidelines.

8.1.4. For these reasons we support the Commission's decision to take a staged approach to approving TPM development expenditure and at this stage to only consult on price path amendments for Transpower's actual opex expenditure to 30 June 2021 (**stage one costs)**.

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[2] Section 54V(5)) of the Commerce Act

[3] Ibid Section 54V(c)

9. Level of prudent expenditure

9.1.1. As an active participant in the TPM reform process, Trustpower can confirm that Transpower has undertaken considerable work in engaging with the Authority and its customers on the development of a very complex proposal by 30 June 2021.

9.1.2. We understand that Transpower's stage one opex costs are around $4.4m. We think that opex of this order of magnitude is reasonable.

9.1.3. It is possible, indeed we would say likely, that some of these stage one costs, including the consultancy spend of $1.6 million, are attributable to the compressed timeframe which was afforded to Transpower for the development of the TPM. That timetable was not of Transpower's making.

9.1.4. Deloitte have verified that:[4]

> *"Costs budgeted for were traceable, attributable to the project objectives, activities and outputs with the level of administrative related costs relatively low and noting that Transpower has not budgeted for and absorbed governance and other related internal staff time and costs associated with the TPM project."*

9.1.5. This provides further comfort that this level of expenditure is within the expected bounds.

10. Conclusion

10.1.1. Trustpower does not consider that this expenditure will yield long term benefits to consumers. However Transpower was legally obliged to develop this TPM.

10.1.2. On this basis we support the Commisison's proposed amendments to allow Transpower to recover its actual stage one expenditure in the in the next regulatory period (RCP4) with an appropriate adjustment for the time value of money.

Regards,

Peter Calderwood
General Manager, Strategy and Growth

[4] Deloitte Transmission Pricing Methodology (TPM) Project Review 2020 Internal Audit Report November 2020 page 4 (available at https://www.transpower.co.nz/sites/default/files/uncontrolled_docs/Assurance%20Deloitte.pdf)