

File note – discussion summary

Date:	24 March 2023, 11.00 am to 11.36 am	17.01 / PRJ0045783
Location:	Virtual attendance using Teams	
Attendees:	Commerce Commission: Paolo Caccioppoli, Matthew Clark, Simon Todd, Beichen Yang, Katherine Nordmeyer. Transpower New Zealand Limited: Joel Cook, Calum Waugh.	
Classification:	For publication	
Subject:	IM Review 2023 Meeting between Commerce Commission and Transpower: accounting treatment of anticipatory connection assets (new asset category under the Transmission Pricing Methodology)	

Restricted information in this document is contained in square brackets

Drafting note: these notes record a discussion on possible treatment of ACA capacity, for the purposes of informing staff analysis in the IM Review 2023. The views expressed in these notes do not represent, and are not to be relied upon, as a formal decision or expression of the Commerce Commission or Transpower New Zealand Limited.

Introduction

1. The purpose for this meeting is for Commission staff to request information about Transpower's approach to the accounting treatment of anticipatory connection assets (**ACA capacity**), to inform staff analysis in the IM Review.
2. This relates to the IM Review, we are currently in a period of active consultation until our final decisions are made. Therefore, the arrangements for this meeting are necessarily formal (reference to agenda and publication of meeting notes).

ACA Capacity

3. Commission staff have been considering the issues raised by the introduction of the Transmission Pricing Methodology into the Electricity Industry Participation Code 2010 (**Code**). In particular, the new asset category of ACA capacity.
4. Transpower has also considered the treatment of ACA capacity. In practice this may apply the complex pricing model for ACA capacity under the Code where 50% of the investment is priced according to the benefits-based simple method and 50% is allocated to the residual category of customers (through transmission charges).

ACA capacity example

5. Customer 1 requests a new connection from Transpower, this requires a substation costing \$8m.
6. If Transpower had good visibility that subsequent movers would seek to join, but uncertainty as to the timing of those connections, it may build additional capacity in anticipation of a subsequent mover. This capacity is the ACA capacity. In this example, this is an additional concrete pad at the substation site, costing \$0.5m.
7. In terms of its regulatory accounts, Transpower would allocate the investment as follows:
 - 7.1 \$7.5m allocated to Customer 1, using a New Investment Contract (**NIC**); and
 - 7.2 \$0.5m enters the Regulatory Asset Base (**RAB**) with a system flag as a future connection asset. This portion is treated in accordance with the 50/50 benefits-based method described above.
8. When a subsequent mover (Customer 2) seeks connection, Transpower would enter into a NIC with them. At this point, the asset value of the ACA capacity taken up by Customer 2 would be replaced in the RAB with a nil value (consistent with the treatment currently required under the IMs) while the remaining depreciated value of the asset would be charged to Customer 2 under the NIC.

Interaction between ACA capacity and the Individual Price Path (IPP) reset

9. Commission staff sought Transpower's views on how the above treatment would apply in the ex-ante context of the IPP. Would this require a specific funding pool that is taken up as ACA capacity is required?
10. One option considered by Transpower is the introduction of a 'use it or lose it' allowance in the IPP of \$25m. This can be used if there is good evidence that a second-mover will take up the ACA capacity in future. This allowance would bypass the ordinary incentives applying to capex.
11. From Transpower's perspective, there is a regulatory challenge in ensuring sufficient scrutiny of any potential ACA capacity – how the IMs provide for an assessment of whether the capex is sufficiently prudent and efficient to the satisfaction of the Commission and consumers. This needs to be considered against the backdrop that this is incremental expenditure only.
12. This is a novel issue that has not required consideration before now. There is still a high level of uncertainty of need for ACA capacity. It is difficult to forecast, but Transpower considers it needs to start somewhere and the approach can be refined over time.

Cost overruns for ACA capacity capex

13. The costs associated with capex under NICs with individual customers are charged on an actual cost basis. Transpower does not have a clear approach at this stage to cost overruns for ACA capacity. Ultimately this may come down to ensuring good cost reporting.

Approach to asset valuation

14. Transpower has not forecast or considered a scenario where ACA capacity is built before an NIC is agreed between Transpower and the first mover (Customer 1). Transpower anticipates that this is unlikely to occur because any ACA capacity would be driven by the NIC (first mover connection asset capex).
15. In Transpower's information system, assets can be separated/allocated using system flags. Put simply, the separated portions of assets need to constitute individual assets. This approach is already applied for a variety of different purposes such as allocating expenditure to different pricing pools or asset classes e.g. interconnection pool of assets.
16. For example: in the event a subsequent mover (Customer 2 or 3) only uses part of the available ACA capacity, Transpower may charge that customer by apportioning the megavolt amperes (MVA) used by that customer. The remaining MVA portion would be allocated to the ACA capacity (this view is subject to confirmation with subject-matter expert).

Interaction with Renewable Energy Zones (REZ)

17. Transpower has considered and consulted upon the uses of ACA capacity in REZs. Transpower is cautious about the potential extent of ACA capacity capex in this context. In the event capex reaches or exceeds existing thresholds, it may fall into the Major Capex Proposal (**MCP**) or Enhancement and Development (**E&D**) reopener processes. There is potential for this to require an adjustment to the IMs.
18. This raises the issue (identified earlier) of the appropriate level of scrutiny for assets of this type. The Commission and consumers may accept a lesser level of scrutiny for smaller, marginal investments. But perhaps where the marginal investment exceeds \$5m, this may reach a threshold where greater scrutiny is required.

Forecasting

19. This concept is new to Transpower and difficult to forecast. When Transpower first investigated ACA capacity, it was not clear what the scope of future capex could be. Transpower has received an increasing number of connection requests (from 5 in 2019 to 100 in 2022). Many of these requests are located at the same grid connection point. Transpower seeks to identify ways to help those connecting customers avoid first mover disadvantage altogether.

Interaction with the input methodologies

20. Consistent with recent submissions, Transpower prefers principles-based IMs, with necessary detail recorded in the IPP. As it stands, the regulatory regime is not always coherent between the various regulatory instruments and the IMs have been reactive to the need. For example, the introduction of the E&D reopener in RCP3 required an IM amendment, even though the detail of this was driven by a change in the IPP for RCP3.
21. Transpower is looking to the IMs for uncertainty mechanisms for resilience. Major events are going to become bigger and more frequent. Transpower suggests that the IMs need to be set up to deal with this in the long term. Commission staff note that the Capex IM allows for resilience capex and that this has been approved in the past as an MCP and in base capex, which may indicate there is no need for specific provisions.

Alternative to an uncertainty mechanism for ACA capacity

22. Commission staff sought Transpower's view on a 'strawman' alternative treatment of ACA capacity. That is, where the entire asset enters the RAB and is gradually removed from the RAB as ACA capacity is taken up by subsequent movers. This would enable the entire cost to be subject to proportionate scrutiny under the existing mechanisms.
23. This would need to enter the base capex allowance, which requires forecasting (ex-ante). However, Transpower is unable to forecast ACA capacity with any kind of certainty, therefore it considers this treatment is not suitable.
24. Although using uncertainty mechanism does involve giving up some scrutiny of the investment, there is a trade-off between this reduced scrutiny and the inability to accurately forecast under the base capex approach.

Uncertainty mechanisms

25. Transpower has considered grouping this type of uncertainty mechanism with the approach used where customers, such as EDBs, request that Transpower brings forward asset refurbishment or replacement expenditure.¹ This can be used where Transpower's customers experience large growth in demand, they agree to pay the incremental cost under an NIC instead of requiring frequent 'band-aid' fixes.

- 25.1 This expenditure is straightforward, so a lesser level of scrutiny is appropriate.

¹ Transpower New Zealand Limited *RCP4 Consultation* (September 2022) at 108 available at https://tpow-corp-production.s3.ap-southeast-2.amazonaws.com/public/plain-page/attachments/Transpower%20RCP4%20Consultation.pdf?VersionId=xQvdzkW9fCPzyDrm4TI4V5ik0LP_sahK.

- 25.2 Where expenditure of this type is allocated to base capex, customers must bear the upside and downside risk. However, where this is subject to a NIC, it makes sense to allocate this risk to customers.
26. Transpower has asked the RCP4 independent verifier to assess whether uncertainty mechanisms could be suitable. It notes that the IMs do not currently allow them.

Attachment A: Email correspondence dated 21 March 2023

Kia ora Rebecca and David,

I am looking up to set up a meeting between the Commerce Commission and Transpower to discuss the feasibility of certain regulatory accounting matters in relation to the IM Review, arising from changes to the TPM. I have included our proposed agenda below.

Treatment of new investments in anticipatory capacity assets (ACAs)

1. Discussion of Transpower accounting process for reallocating ACA costs under TPM from identified regional beneficiaries and pooled charges to first and subsequent mover connection customers.
2. Discussion of incorporation of ACAs into Part 4 regulatory regime:
 - a. Accounting for ACAs in Part 4 RAB if treated as RAB assets
 - b. Accounting for removal of assets from Part 4 RAB as capacity taken up
 - c. Transpower ID requirements for ACA assets

Given that this meeting is on matters related to the IM Review, we intend on publishing our notes from the meeting after sending a draft to you for review. Before we do so, we will consult with you about the need to redact any commercially sensitive information.

Attendees at the meeting from the Commerce Commission will be:

Paolo Caccioppoli (Principal Advisor)
Simon Todd (Chief Advisor)
Katherine Nordmeyer (Legal Counsel)
Beichen Yang (Analyst)

Could you get back to us with your availability for a meeting for one of the following 3 slots?

Friday, 24 March 11 AM – 12PM
Monday, 27 March 3 PM – 4 PM
Thursday, 30 March 3 PM – 4 PM

Ngā mihi,

Chris Peters

Project Manager, Electricity Distribution

Commerce Commission | *Te Komihana Tauhokohoko*

Level 12, 55 Shortland Street | PO Box 222-105 | Auckland 1143 | New Zealand

www.comcom.govt.nz