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Submissions  
 Electricity Authority  
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Dear Carl,

**RE: TPM: Second issues paper: Supplementary consultation Cross submission**

The Independent Electricity Generators Association (IEGA) is making a submission on a principles basis on the Electricity Authority’s (Authority) decision to stipulate a methodology for the valuation of new and existing assets covered by the proposed Area-of-Benefit charge in the TPM Guidelines. The IEGA comprises about 40 members who are either directly or indirectly associated with predominantly small scale power schemes connected to local networks throughout New Zealand for the purpose of commercial electricity production.<sup>1</sup>

Previous submissions highlighted the large reallocation of value from one stakeholder to another and for there to be unintended consequences. Over the last 18 months this consultation process has progressively deteriorated as debate over these consequences has escalated reflecting wealth transfer issues. This cross submission on asset valuations is the latest example. Refer summary table.

Issues Raised in TPM Submissions	Estimated Wealth Transfers	CBA Cost-Benefits	Outcomes
DG ACOT Removal	NPV\$320m	NPV\$2m to \$20m	Reliability Std. 2018
DG Common Costs Allocation	NPV\$1,000m+	Not Clear	2019 Review flagged
Area of Benefit Charges	NPV\$1,500m+	NPV\$242m	Weaker Peak Signals
Adjusted AMD’s for Selected Parties	NPV\$100m	Not Clear	Prudent Discounts
3.5% Price Cap for Selected Parties	NPV\$50m	Not Clear	Wealth Transition
RCPD Peak Price Removals – Energy Costs and TX Losses	NPV\$2,500m+	Not Considered	Higher Overall Consumer Costs
Valuation Change to AOB Assets	NPV\$400m	Not Clear	Not Yet Clear
<b>Total Estimated Wealth Transfers<sup>2</sup></b>	<b>&gt; ~NPV\$5bn+</b>	<b>Est. ~NPV\$250m</b>	

<sup>1</sup> The Steering Committee has signed off this submission on behalf of members

<sup>2</sup> These estimated wealth transfers as noted in various TPM submissions and the Authority’s reports

IEGA is very concerned at this estimated NPV\$5bn level of stakeholder wealth transfers arising from Code changes that generate a meagre estimated NPV\$250m of CBA benefits. We noted from an earlier submission that the impact of these wealth transfers is no different to the Authority's Chair<sup>3</sup> comments on the prior Labour Greens NZ Power proposals, noting that these proposals:

*“propose unilateral and ex post wealth transfers from producers to consumers that would have a chilling effect on investment in the electricity sector, and probably elsewhere in the economy.”*

We also note that the Authority's interpretation of its statutory objective<sup>4</sup> states that;

*“if wealth transfers seriously undermine confidence in the pricing process or in the electricity industry more generally then that can inhibit efficient entry and investment decisions and these dynamic efficiency effects should be taken into account when evaluating proposals”.*

The level of wealth transfers created by this TPM proposal has had a chilling effect on our membership, both as market investors in the electricity industry and consumers of electricity, and undermines our confidence in the pricing processes. Worse still, letters we have received from the Authority during this consultation process has dismissed these wealth transfers as not relevant to the Authority's decision relating to its statutory objectives. We disagree.

Our members have approximately \$1bn of existing generation assets and have ~200MW of new generation investment proposals with consents that have limited lives. The generation sector has a 4,000MW pool of consented generation sites. Securing and maintaining these consents costs money. We believe this extended regulatory change process and the pricing and costs uncertainty being created in the TPM Guidelines is unacceptable, and that pragmatism must now prevail.

### **Application of economic and regulatory practices**

The Authority has provided no information about what has triggered it to seek further feedback on this issue – information which would assist stakeholders in framing their responses. It appears this process of cross submissions reflects wealth transfers between different transmission customers from one particular aspect of the entire Guidelines. We are confused about the Authority's decision to undertake cross submissions on this one, very specific, aspect of the proposed TPM Guidelines. Further, the valuation methodology at clause 6 and 26-30 in the Guidelines is one of numerous 'bright lines' created by the Authority in its drafting of detailed and complex Guidelines. Others include for example:

- the eligible investments (clause 8)
- how to assess net private benefits (clause 18)
- process of how and when to optimise assets (clauses 19-21)
- dealing with over-recovery (clause 29)
- special treatment of large customers (clauses 34-36)
- cap on annual increases (clauses 54-66)

This level of granularity and specificity in the Authority's proposed Guidelines is not supported by other parties in their submissions. We note in particular the expert comments by Professor Yarrow in his submission<sup>5</sup>. Having considered the requirement for Guidelines in the context of international practice applying to pricing structures for regulated transmission monopolies, he concluded:

*“There is greater variation in regulatory practice among jurisdictions in approaching price structure issues than there is for average pricing issues, but the centre of gravity of approaches*

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<sup>3</sup> See <https://www.ea.govt.nz/dmsdocument/15066> para 98

<sup>4</sup> See <https://www.ea.govt.nz/dmsdocument/9494>

<sup>5</sup> See: <https://www.ea.govt.nz/dmsdocument/21897>

*adopted in practice can be said to be characterised by the granting of significant discretion to a regulated firm in respect of its choice of price structure.” (page 2)*

*“In the NZ context, therefore, the TPM Guidelines appear intended to perform a role not dissimilar to that of equivalent documents published by enforcement agencies in UK/EU competition law regimes, i.e. they are there to assist a business in understanding the obligations and constraints emanating from more general laws and regulations, not to add a further, authoritative level of obligations and constraints. If this interpretation is correct – and the terminology (‘Guidelines’, rather than ‘Regulations’) is consistent with the interpretation – it is not to be expected that the TPM Guidelines will be a prescriptive document.” (page 2)*

Professor Yarrow goes on to say:

*There are very good reasons for the delegation of discretion to the utility concerned which are to do with the discovery of information. ...*

*The rationale for the delegation of discretion ... is simply that the utility itself is likely to be in a better position to engage in the discovery exercise than a government agency, being a commercial entity that is closer to its customers and has a closer acquaintance with its own costs. ... In the end, however, the policy judgment comes down to choosing the least bad of the alternatives, and the relative comparator (against which to assess a utility’s capabilities) is a governmental organisation of one kind or another which typically has rather more attenuated incentives and less immediate access to sources of information.*

*There is clearly a trade-off here: discretion is good for discovery, but it carries some risks of its own. Since the discovery of new, economically valuable information is the engine of economic progress, it should be unsurprising to find that regulatory approaches tend in general allow for significant, but not unbounded, discretion. (page 3-4)*

We agree with Professor Yarrow’s submission views. The Authority has also acknowledged this and expressed a similar view in its Supplementary consultation paper<sup>6</sup> in December 2016:

*“Because Transpower has greater operational knowledge than the Authority about electricity transmission, the Authority considers Transpower is best-placed to propose a detailed methodology.” (para 4.9(b))*

The Supplementary consultation also proved that small changes in assumptions can have a major impact on indicative charges. This calls into question the durability of the entire proposal unless Transpower, as the ultimate accountable party has the *delegation of discretion* as noted by Professor Yarrow. The Authority has provided no evidence that a particular valuation methodology results in a positive or higher NPV in its cost benefit analysis. We note that Transpower will complete and consult on a cost benefit analysis when it converts Guidelines to a methodology.

### **Overlaps with Commerce Commission regulatory jurisdiction**

In addition to the above rationale for more principles based Guidelines, IEGA is concerned about the lack of coherence between two government regulators and the potential contradictions in approach to transmission, distribution and emerging technologies. We note that the Commerce Commission has recently announced it is commencing its 7 yearly review of the Capex IM for Transpower next month. This obviously includes the valuation methodology for determining Transpower’s maximum allowable revenue requirement.

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<sup>6</sup> <http://www.ea.govt.nz/dmsdocument/21572>

Answering the question of this cross-submission, we recommend the Authority does NOT stipulate a valuation methodology for assets subject to the AoB charge in the TPM Guidelines. A principal of a 'time neutral valuation methodology' for both the AoB and Residual charges is sufficient. If there is a competition reason for the valuation method for setting price levels (ComCom) to be different from the valuation method for setting price structures (Authority) the TPM Guidelines can require Transpower to explain the reason for the difference, as opposed to stipulating the valuation methodology in the Guidelines.

## Conclusions

We note from submissions Covec's report, supported by a number of informed industry parties, and the questions raised on the quality of CBA analysis highlight uncertainty. We therefore conclude that there is insufficient evidence the Authority's proposals meet its statutory obligations, to the extent claimed in its reports. More generally, the IEGA:

- is concerned about the Authority's governance of this TPM process which has extended over five years and involved millions of dollars in costs, including 60 reports from experts that it appears the Authority has ignored<sup>7</sup>;
- is also concerned about the magnitude of wealth transfers; the minimal, if any, positive NPV from the proposal; and the uncertainty created by the Authority;
- believes the proposed TPM will not be durable; and
- recommends the Authority revisit its process, apply Code Amendment Principle 4 and implement Transpower's simplified staged alternative to changing the TPM.

In the interests of all stakeholders, IEGA recommends that;

- the Authority revisit its Code Amendment Principle 4 which states a preference for initially small-scale, flexible, scalable and relatively easily reversible Code changes with relatively low value transfers associated with the change; and
- Transpower's simplified and staged alternative be adopted (and include an LRMC) be included in the tie-breaker Options. Transpower has provided substantial detail about this approach and we are surprised the Authority has summarily dismissed it.
- A Status Quo scenario also be included in the tie-breaker options, but using empirical evidence to quantify the cost-benefits. Transpower could modify the Status Quo per their 2016 Operational review to resolve problems identified through empirical analysis.

We would welcome the opportunity to discuss this submission with you.

Yours sincerely



**Warren McNabb**  
Chairman

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<sup>7</sup> See: <http://www.ea.govt.nz/dmsdocument/21877>