24 June 2014

Submissions
Electricity Authority
By email: submissions@ea.govt.nz

Transmission Pricing Methodology Review: Connection charges

Meridian welcomes the opportunity to provide feedback on the Electricity Authority's working paper "Connection charges" dated 6 May 2104.

The connection charging regime can be improved. In particular, by averaging capital costs and notionally allocating operating expenses, the efficiency of the charging mechanism is blunted. A principled approach would be to have connected parties face the full costs of the actual assets (and associated operating expenses) used for connection to the greatest extent practicable.

Accordingly, but subject to a quantitative cost-benefit analysis, Meridian supports[1]

- moving from average replacement cost (ARC) to depreciated replacement cost (DRC) charging; and
- maximising the recovery of operating expenses on the basis of actual costs rather than through notional cost allocators.

In principle, these modifications would provide connected, connecting, and disconnecting parties with appropriate incentives in relation to:

- making trade-offs between connection options
- determining and responding to the timing of renewals
- determining whether to contract with Transpower or engage another party to provide the assets; and
- assessing maintenance and repairs.

The remainder of this submission contains Meridian's comments on the three issues raised by the EA. Given that the options discussed in the working paper are not exhaustive and given the potential interdependence of various aspects of the TPM, this submission does not attempt to comprehensively state Meridian's position.

IS THERE POTENTIAL FOR CONNECTION ASSETS TO BE INEFFICIENTLY CLASSIFED AS INTERCONNECTION ASSETS?

Meridian agrees that the different treatment of connection and interconnection assets for charging purposes can create inefficient incentives. In particular, under the current pricing methodology, parties may be incentivised to connect to the grid in a way that is treated as interconnection rather than connection.

We support the EA's proposals. That is, to:

[1] Meridian also refers to its submission on the October 2012 Issues Paper (1 March 2013), pp 24-25.

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- consider whether improved targeting of interconnection charges sufficiently addresses this concern; and
- consider developing a policy which would govern the classification of connection costs during commissioning.

Meridian also notes that the due to circumstances outside a connection customer's control (such as an investment initiated by Transpower), the customer's connection assets may be incorporated into the interconnected grid. It is submitted that in such circumstances there should be flexibility for the classification to be changed to reflect the use of the assets. For example, the EA could determine the appropriate classification upon application from either Transpower or the customer.

WOULD MOVING TO DEPRECIATED REPLACEMENT COST IMPROVE EFFICIENCY?

Meridian broadly agrees with the EA's analysis of reasons for and against moving to DRC.

Meridian considers that, in principle, DRC-based charges will guide better investment decisions and promote dynamic efficiency. Uncertainty about the asset's life would be taken on by the customer(s), which is desirable in this context. Meridian supports the principle that the costs and benefits for these decisions need to be considered and addressed by the customers, not the asset owner i.e., if two parties share a driveway it is up to those parties - not the roading company - to address any repair and replacement.

Despite the principle appearing sound, Meridian acknowledges there may be costs to implement this approach. We acknowledge that DRC charge may give rise to practical difficulties in relation to connection assets used by more than one customer. For example, at the end of the life of a shared asset, parties may be less likely to agree as to the timing of a replacement given the discontinuity between charges for old and new assets under DRC charges. The EA should undertake a quantitative comparison as part of its second issues paper, with input from Transpower as to what the difficulties and costs may be.

IS THERE AN ISSUE OF CROSS-SUBSIDISATION OF OPERATING EXPENSES?

Meridian supports operating expenses being recovered on the basis of actual costs rather than through notional cost allocators to the extent practicable.

Meridian agrees with the EA that it is more efficient for connected parties to face actual costs so that they face proper incentives in relation to steps they can take themselves and monitoring Transpower's activities.

Please contact me if you have any questions about this submission.

Yours sincerely,

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