MIGHTY RIVER POWER

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Transmission Pricing Methodology Review: Connection Charges

Mighty River Power welcomes the opportunity to comment on the Transmission Pricing Methodology (TPM) working paper on connection charges. No part of this submission is confidential.

Mighty River Power supports the connection charging regime under the current TPM. We agree with the Authority's assessment from its original TPM proposal that:

> "… the arrangements for obtaining and providing connection services are generally operating effectively and promote efficient investment in the transmission grid… in generation, distribution and by electricity consumers."[1]

The problem definition and potential inefficiencies outlined by the Authority in its original proposal and subsequent working paper have not been quantified with real world examples, despite significant historical and recent investment in connection assets.

Incentives to shift connection charges to interconnection

Connection charges are rarely a substantial or determining cost component of a new generation investment, where the capital costs associated with the plant can be orders of magnitude greater in significance.

There will also rarely be opportunities for generation to be located within the grid where the shifting of connection charges to interconnection would be technically possible. As Mighty River Power has consistently argued, the main driver of generation location decisions is access to the underlying fuel resource, not transmission costs.

In our view Transpower would act as an effective arbiter of any attempts to inefficiently shift of connection charges if they were to arise. Transpower has publicly indicated its regulatory context strongly incentivises it not to undertake such inefficient investment[2]. This is in direct contradiction to the Authority's view that it faces incentives to accede to participant requests to shift connection charges to interconnection as it would increase its RAB returns.

[1] TPM Issues and Proposal (October 2012) 4.2.12
[2] TPM Conference Day 3 Transcript - Pgs 376-377

The limited evidence base that can be identified supports Transpower's contention. As noted in the Authority's original issues and proposal paper, where there has been potential for inefficient shifting of connection charges, the issue has been resolved contractually between Transpower and the connecting party and any potential inefficient outcomes avoided[3].

The fact that the Authority has only been able to identify one additional example in its working paper, Meridian's Project Aqua which did not progress, indicates that the incentives the Authority is concerned with are not leading to material inefficiencies in practice. Mighty River Power is of the view that the existing arrangements are sufficient to manage any issues should they arise.

This is borne out by the low level of responses the Authority received to what it classified as 'relatively minor problems' with the connection charging arrangement in its original TPM proposal[4]. Connection charging also received very limited focus at the TPM Conference[5].

Average versus depreciated replacement cost

Mighty River Power does not support any shift from an average to depreciated replacement cost or that even in theory there are material inefficiencies with the current arrangements.

The Authority's contends that a saw tooth pattern of depreciation more efficiently approximates the value and level of service provided to customers of connection assets.

As a connection customer, the value Mighty River Power places on a connection asset is constant to growing over time (depending on demand), rather than decreasing. Further, it is incorrect to classify connection assets as experiencing a consistent degradation in level of service. Connection assets will tend to provide highly consistent levels of service over time up to a point of failure.

Mighty River Power considers the most efficient basis for charging for connection would be to determine charges on the basis of SRMC and LRMC of the underlying assets. It is not at all clear that the proposed saw tooth pattern would approximate such a charge. In any regard, given the large volume of connection assets it would clearly not be pragmatic to charge on a marginal cost basis, hence the preference for averaging.

[3] Refer TPM Issue and Proposal Pg 50 section 4.2.16 onward
[4] Summary of Responses: TPM Issues and Proposal (May 28 2013) Section 8
[5] Only two participants were questioned with the majority of attention focussing on Transpower. See TPM Conference Day 3 Transcript - Pgs 372-381

Further, the correct basis for considering whether a cross-subsidy exists between customers with older connection assets to those with newer assets is whether some customers are paying below incremental cost.

The main theoretical benefit from a shift to depreciated charging appears to be that it will provide greater dynamic benefits via increased participant scrutiny and removing incentives for hold-out or lobbying for early or more regular replacement of assets.
As the Authority notes, average charges are likely to equal depreciated charges over time. For investors in long lived generation and load assets the NPV impact of either charging arrangement is likely to be similar. It is therefore unlikely a shift to depreciated cost will materially alter incentives for scrutiny.

The Authority's contention that there are theoretical incentives to lobby for more frequent replacement of connection assets under an averaging approach is not supported by evidence. Given that connection assets will generally provide a consistent level of service it is unclear on what rationale basis Transpower would be able to approve such requests.

Again, given the lack of actual real world evidence of any inefficiency the perceived incentives are unlikely to be material in practice, particularly given the average cost approach has been in place for some time.

We do agree that a sudden step change and continued volatility in the connection charging arrangements would be undesirable from a customer perspective. The Authority has received clear feedback from participants in response to its SPD methodology for charging beneficiaries that volatility in charges is undesirable. The Authority appears to have accepted these concerns in recent revisions to that methodology to provide more smoothed charges. We understand that volatility of charging was one of the main reasons why there was a return to average charging from the depreciated approach that was experimented with in the 1990s.

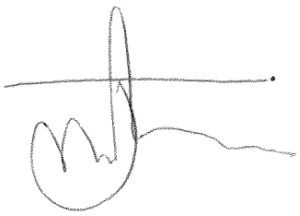
Closing remarks

There does not appear to be sufficient evidence that the current connection charging arrangements have resulted in material incentives for inefficient behaviour. Further, there does not appear to be a compelling theoretical rationale that a shift to depreciated replacement cost charging regime would result in material dynamic efficiency benefits.

Mighty River Power supports the retention of the status quo arrangements for connection charging.

If you have any questions please contact Nick Wilson, Senior Market Regulatory Advisor nick.wilson@mightyriver.co.nz on 095803623.

Yours sincerely



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