COUNTIES POWER

24 March 2017

Submissions
Electricity Authority
PO Box 10041
Wellington 6143

By email: submissions@ea.govt.nz

Cross-submission: Area-of-benefit valuation methodology

Counties Power appreciates the opportunity to provide a cross-submission on the area-of-benefit (AoB) valuation methodology. The short timeframe for consideration of this critical issue is unfortunate as we feel we have not been able to apply sufficient analysis across various submissions that this matter is due.

In preparing its arguments Counties Power reviewed the submissions on the December transmission pricing methodology (TPM) proposal[1], and is cross-submitting in response to submissions from Meridian Energy, Contact Energy and Pacific Aluminium (Submissions). Until now Counties Power had not submitted on the area-of-benefit historic asset valuation methodologies, but appreciates the opportunity to cross-submit on them.

Oppose DHC methodology

Counties Power is strongly opposed to the Submissions proposals whereby the AoB charges recover historic investments based on a depreciated historic cost (DHC). AoB charges should be set based on indexed historic costs (IHC), which will provide price stability and ensure more of a market based pricing approach.

Counties Power believes that the DHC methodology will erroneously inflate the AoB charges for the recent NIGU and NAaN investments[2]. As a result, the AoB charges for these projects will follow the depreciation curve on the assets as opposed to the benefits, which results in the charges being set too high initially and too low as the assets approach end of life. We also believe that the DHC methodology would erroneously reduce AoB charges for the HVDC pole 2 investment rather than set the charges to reflect the level of the benefits that are received.

We note Meridian's opposition to the IHC charge as being rejected by the Commerce Commission and the Courts. While the DHC methodology may be appropriate in certain regulatory settings this doesn't automatically mean that the methodology is correct in

[1] *Transmission Pricing Methodology: Second issues paper: supplementary consultation*, 13 December 2016.
[2] North Island Grid Upgrade (NIGU) transmission project commissioned in 2012 and the North Auckland and Northland (NAaN) project commissioned in2013.

setting AoB charges. This is because the use of the DHC methodology may be correct in regulatory models that determine overall regulated asset returns that could be earned[3]. However, the TPM isn't about total returns but instead about economic efficiencies across the system from improved price signals. Counties Power would also like to note that the notion of Meridian, Contact and Pacific Aluminium ending up "paying twice" under the IHC methodology is illogical; all transmission assets have been shared amongst all users using the current methodology – not paid for by specific users and so historic transmission charges are irrelevant.

Counties Power believes that the IHC valuation methodology is appropriate because it reflects a market based pricing approach, the preferred option under the Authority's decision-making and economic framework for transmission pricing. The IHC methodology would produce a market pricing approach because it results in transmission pricing for a service not an asset. In particular, pricing should be the same where identical transmission services are offered; market charges should not vary by the age of the asset but should vary by the level of the service (e.g. a truck hauling freight is not charging based on the age of the truck).

Counties Power believes that Pacific Aluminium's argument that this logic can't be applied to transmission networks is flawed. While there may be no specific electricity transmission examples in New Zealand, there are other similar transmission infrastructure examples such as the South Cross Cable, that provides nearly all of New Zealand's international communications. Charges for this service do not vary with the age of the asset but are based on the service provided; similar to the existing electricity transmission charging methodology.

Consultation process

The valuation of assets to determine AoB charges is a complex area that has a material financial impact on Counties Power. Consequently, Counties Power believes that providing ten working days for cross-submissions is grossly insufficient given the large number of submissions, the opacity of quantitative information and the dearth of detailed notes on modelling assumptions from the Authority on the impact of the valuation methodologies.

Counties Power is not a large organisation with resources available to quickly dedicate to the preparation of the cross-submission and determine the quantitative impacts for its consumers. The timeframe set by the Authority favours larger organisations that can mobilise regulatory and analytical teams to consider such matters. For this reason, Counties Power believes that Authority's consultation process is flawed and further information and time is required to consider this issue.

Yours sincerely
COUNTIES POWER LIMITED

[3] An example being the Transpower default price path set by the Commerce Commission.

Andrew Toop
COMMERCIAL MANAGER