

25 June 2019

Jo Mackay  
Project Manager  
Electricity Authority - Te Mana Hiko  
Level 7 Harbour Tower  
2 Hunter Street  
Wellington 6143  
[By email]

Dear Jo

**TRANSMISSION PRICING METHODOLOGY COST BENEFIT ANALYSIS REPORT**

Further to your request, this letter confirms the role Advisian has undertaken in supporting the Electricity Authority (the Authority) develop the cost benefit analysis (CBA) prepared in seeking approval of the proposed Transmission Pricing Methodology (TPM) and comments on the suitability of the CBA for the intended purpose.

Advisian's work was divided into three phases, each of which is discussed below:

**Phase One – Review and comment on the CBA Preparer's high-level methodology proposed for undertaking the CBA**

Our comments on the report prepared for stage one highlighted several matters that needed clarification. Key among these was a need to justify the use of a partial equilibrium model to complete the CBA over more traditional discounted cashflow models. In addition, it was also suggested that the authors make it clear how this analysis will ensure that only benefits and costs arising from the TPM change are carried forward to the CBA analysis.

Following discussion with Authority staff and the CBA preparer, Advisian was provided with comfort that our recommendations would be actioned.

**Phase Two – Review of Phase Two report and answers to seven specific question**

Following a review of the Authority's Stage Two report Advisian prepared a brief report setting out several matters for consideration and answered the seven questions asked. The important finding presented was that the general approach to analysis documented in the report is supported by Advisian and that it follows typical steps in the CBA process. However, we also noted that clarification of the steps followed, and assumptions made could improve transparency and make the complex model easier to understand.

With respect to the seven questions, Advisian was asked to specifically comment on whether “the overall design, methodology and economic foundations of the planned CBA are consistent with best practice.”

In response we commented that we would not describe the overall design, methodology and economic foundations as consistent with “best practice”. This comment reflected the use of bespoke models to undertake the CBA. However, subject to this caveat, Advisian did agree that what is described in the report is consistent with good practice.

It is important to note that Advisian was not asked to undertake any audit of the proposed models. The Authority engaged a third party to undertake this review.

### **Phase three – Review of draft results of the CBA and three specific questions**

Advisian was provided with a draft report setting out the CBA results. Following our review of this report we answered three questions asked of Advisian:

- Is it (the CBA) consistent with the approach you’ve seen before?
- Is it well-enough described in sufficient detail? If not, what is missing?
- How do you think it will be received?

To answer the first question, we referred the Authority to our paper Transmission Pricing Methodology - CBA Phase Two Working Paper Review. As noted in our Phase Two report, the general approach to analysis documented in the report is supported by Advisian and that it follows typical steps in the CBA process.

In answer to the second, Advisian noted a small number of areas where greater clarity was required. In particular, we noted the significant marked increase in net benefits arising from an implementation of the proposed TPM, when compared with the results from the previous Oakley Greenwood study, and the need to provide some comment on this in the report. We also highlighted areas where comments are made that were not backed by evidence. The Authority has responded to our comments, acknowledging that these will be addressed in the final report.

Advisian chose not to answer the third question, noting that if a party wants to find fault in a report they undoubtedly will.

We also provided 25 comments on specific matters in the report. The Authority has provided Advisian with detailed responses to our answers to the three specific questions, and 25 comments. We note that our comments have generally been accepted and addressed by the Authority in preparing their final report. In the other instances, an explanation for the position taken has been provided.

## **Suitability of the CBA for its intended purpose**

In commenting on the suitability of the CBA, it must be remembered that our role was limited to the matters set out in the three phases discussed above. Advisian did not, nor was it asked to, undertake a comprehensive review of the CBA.

As mentioned above, Advisian believes that the approach used in modelling and preparing the CBA is consistent with good practice. We have been informed that an independent third party has audited the accuracy of the models and we assume that identified issues (if any) were addressed.

Although Advisian provided comments on several of the assumptions used in preparing the CBA, we were not asked, nor have we reviewed the accuracy of the input data (information) used in modelling. We have relied on Authority staff to undertake this role.

While we have neither received nor reviewed the final report, the representations made by the Authority in respect to our comments on the draft report, provide comfort that they have been addressed. On this basis, we are satisfied that the CBA is suitable for its intended purpose.

Yours sincerely



**Erik Westergaard**  
**Senior Associate**