



**SOUTHERN
GENERATION**
LIMITED PARTNERSHIP

22 June 2022

Submissions
Electricity Authority
P O Box 10041
Wellington 6145

By email: tpm@ea.govt.nz

Dear TPM team,

Re: Consultation Paper – PDAs / NEC

The Southern Generation Limited Partnership (SGLP) is a counterparty to the Prudent Discount Agreement with Trustpower, Transpower and Horizon Energy relating to the Aniwhenua and Matahina hydro power stations. This agreement recognises that output from the Aniwhenua power station could be injected into the Horizon network and bypass the existing transmission grid which is an inefficient outcome.

Analysis of the [current Code](#) (which has not been updated for the new TPM) and the [TPM published](#) by the Authority in April 2022 reveals there has been no or minimal change to the rules relating to the purpose of a PDA, or the economic test to assess a PDA is the most efficient outcome.¹ The Authority acknowledges this in paragraph 2.2:

2.2 Broadly, these contracts provide transmission customers with prudent discounts on their transmission charges. The purpose of each was to encourage the relevant parties to remain connected to the transmission grid, rather than bypassing the grid (e.g. connecting generation directly to a distribution network, rather than to the grid) in the context of the then existing TPM (and the financial incentives that created). This is similar to the purpose of the inefficient bypass limb of the prudent discount policy under the new TPM. [emphasis added]

We disagree that current PDAs can be inconsistent with the principles of the new TPM (beneficiaries pay) when the new TPM allows Transpower to sign PDAs with customers with the same purpose and test as the existing contracts. While the Authority might state that (paragraph 2.3):

“The Authority considers that the existing wording of the Code (clause 12.95) and the TPM (clause 10(5)) means that any current PDAs will likely cease to have effect at the commencement of the new TPM as the Code requires transmission charging to be in accordance with the TPM (aside from some exceptions listed in clause 12.95).”

we disagree – clause 12.95 does not refer to prudent discounts (only notionally embedded contracts) and clause 10(5) is about the allocator and a process that recognises there can be new PDAs.

¹ We have included an Appendix of this analysis – mostly for our own understanding

With respect to the PDA that SGLP is a signatory to, there has been no change to the location and connection of generation, distribution or transmission assets that influence whether a prudent discount is appropriate. It is only the fact that the Authority is imposing a new way of recovering transmission costs that has follow-on consequences.

The old and new TPM rules state a PDA is based on comparing the current and future cost of transmission with the cost of distribution assets. But the question is ‘Has the cost of the transmission grid at the relevant point/s of connection declined so much under the new TPM that an alternative investment (bypassing the grid) would now be more expensive than using the transmission grid?’ This is what is implied by the Authority’s paper (paragraph 2.7):

“If these agreements were to continue, however, the risk is that they would provide discounts that are not necessary to prevent inefficient grid bypass under the new TPM. This is because of the substantial differences between the new TPM and the transmission pricing arrangements under which these contracts were entered into, meaning a core part of the bargain these contracts were based on effectively disappears.”

In summary, SGLP strongly disagrees with option 3. We acknowledge the Authority does not support this option, stating:

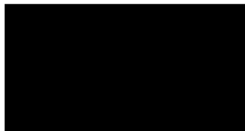
*“The Authority prefers to honour contractual bargains and risk allocations where possible. So, option 3 is not the Authority’s currently preferred option.”*²

We note the Authority is proposing a different approach for the existing NEC (ie overriding the contract) but we are not in a position to comment on the rules / analysis relating to the existing NEC.

SGLP supports Option 1 – that the Authority take no action – with respect to existing Prudent Discount Agreements.

Please contact me if you require further clarification in relation to this submission.

Yours sincerely,



Fraser Jonker
Managing Director

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APPENDIX – Comparing old and new TPM rules (overleaf)

² Paragraph 3.6 of consultation paper

| OLD TPM | NEW TPM |
|---|--|
| Purpose of the Prudent Discount Policy | |
| <i>Prudent Discount Policy</i> | <i>Inefficient Bypass Prudent Discount</i> |
| <p>36 Purpose of the Prudent Discount Policy</p> <p>(1) The purpose of the prudent discount policy is to help ensure that the transmission pricing methodology does not provide incentives for the uneconomic bypass of existing grid assets. The prudent discount policy aims to deter investment in alternative projects which would allow a customer to reduce its own transmission charges while increasing the total economic costs to the nation as a whole.</p> | <p>127 Purpose of Inefficient Bypass Prudent Discount</p> <p>The purpose of an inefficient bypass prudent discount is to help ensure this transmission pricing methodology does not provide incentives for a customer to invest in an alternative project that would allow a customer to reduce its own transmission charges, by bypassing existing grid assets, while increasing total economic costs.</p> |
| Requirement for technical, operation and commercial viability | |
| <p>(2) In order for a customer to obtain a prudent discount a customer’s alternative project must be—</p> <p>(a) technically, operationally and commercially viable and have a reasonable prospect of being able to be successfully implemented; and</p> <p>(b) uneconomic to implement given Transpower’s economic costs of providing existing grid assets and the economic costs that would be incurred by the customer if it proceeded with the alternative project,— determined in accordance with this prudent discount policy.</p> | <p>129 Assessment of Equivalence, Feasibility and Commercial Viability</p> <p>Transpower must assess whether the alternative project for an inefficient bypass prudent discount—</p> <p>(a) would provide the customer with the same or a substantially similar level of service as the transmission services the customer currently receives from the grid assets the alternative project would bypass; and</p> <p>(b) is technically feasible using present day technology and construction methods, including that it is feasible for the customer to obtain the necessary resource consents and property rights for the alternative project; and</p> <p>(c) is operationally feasible, including that the alternative project is compliant with applicable asset owner performance obligations, technical codes and any other requirements in Part 8 of this Code; and</p> <p>(d) is otherwise consistent with GEIP; and</p> <p>(e) is commercially viable under subclause 118(1).</p> |

| OLD TPM | NEW TPM |
|--|--|
| Assessment of whether alternative project is uneconomic | |
| <p>39 Assessment that the Alternative Project is Uneconomic</p> <p>(1) If Transpower considers that the alternative project does not satisfy one or more of the criteria specified in clause 38(1), no prudent discount will be provided.</p> <p>(2) If Transpower considers that the alternative project satisfies all of the criteria specified in clause 38(1), Transpower will, within a reasonable time thereafter, assess the alternative project to determine whether or not it is uneconomic in accordance with subclauses (3) to (7).</p> <p>(3) Transpower will calculate the present value of the estimated total costs of the alternative project including capital costs and operating and maintenance costs. Transpower may use the cost estimates provided by the customer or may reasonably adjust those costs to reflect current market prices, good engineering practice and consequential impacts of the alternative project on grid assets and the customer's assets.</p> <p>(4) The discount rate used to undertake the calculations required by subclauses (3) to (7) must be a discount rate determined by the Authority, from time to time, or if the Authority has not determined a discount rate, a discount rate of, or equivalent to, a pre-tax real rate of 7%. The calculations required by subclauses (3) to (7) will be carried out using a period of 15 years or the remaining life of the grid assets which the alternative project would bypass, whichever is the lesser.</p> <p>(5) Transpower will then calculate the present values of—</p> <p>(a) Transpower's costs of continuing to provide transmission services to the customer if the alternative project does not proceed, including operating and maintenance costs and planned future capital expenditure needed to maintain required service levels; and</p> <p>(b) Transpower's costs of continuing to provide transmission services to the customer if the alternative project does proceed, including operating and maintenance costs and planned future capital expenditure needed to maintain required service levels.</p> <p>(6) If the amount calculated under subclause (5)(a) minus the amount calculated under subclause (5)(b) is greater than the amount calculated under subclause (3), the alternative project will be determined to be economic and no discount will be provided.</p> <p>(7) If the amount calculated under subclause (5)(a) minus the amount calculated under subclause (5)(b) is less than the amount calculated under subclause (3), the alternative project will be determined to be uneconomic.</p> | <p>130 Assessment whether the Alternative Project is Inefficient</p> <p>(1) If Transpower determines the alternative project for an inefficient bypass prudent discount satisfies all of the criteria in clause 129, Transpower must assess whether the alternative project is inefficient under subclause (2).</p> <p>(2) The alternative project is only inefficient if it is reasonably likely that—</p> $PVAPC > (PVT_{C_{no\ ap}} - PVT_{C_{ap}})$ <p>where</p> <p>PVAPC is the present value of the capital, operating, maintenance and overhead costs of the alternative project, including, but not limited to, the alternative project costs</p> <p>$PVT_{C_{no\ ap}}$ is the present value of Transpower's capital, operating, maintenance and overhead costs of providing transmission services to the customer at the required service levels, including the cost of future transmission investments, without the alternative project calculated under subclause (3)</p> <p>$PVT_{C_{ap}}$ is the present value of Transpower's capital, operating, maintenance and overhead costs of providing transmission services to the customer at the required service levels, including the cost of future transmission investments, with the alternative project calculated under subclause (3).</p> <p>(3) In calculating the present values under subclause (2) (PV), Transpower must use the formula:</p> $PV = \sum_n \frac{C_n}{(1+r)^n}$ <p>where</p> <p>C_n is the relevant costs for year n of the relevant prudent discount calculation period</p> <p>r is the relevant prudent discount rate, which must be pre-tax if the cash flows being discounted are pre-tax and post-tax if the cash flows being discounted are post-tax.</p> |