

14 March 2006

Dr Ralph Craven
Chief Executive
Transpower New Zealand Limited
P O Box 1021
Wellington

Dear Ralph

Transpower's Application for Approval of Interim Grid Expenditure for Grid Development Proposals (GDPs)

On 31 October 2005, Transpower applied to the Electricity Commission (**Commission**) for approval of interim grid expenditure (**IGE**) for a number of grid investment projects termed 'Grid Development Proposals' (**GDPs**) (**31 October Application**). On 16 December 2005, Transpower applied for approval of IGE for two additional GDPs (**16 December Application**). The applications are referred to collectively in this letter as the **GDP Applications**.

The rules relating to applications for IGE are contained in rule 16 of section III of part F of the Electricity Governance Rules 2003 (**Rules**) (**Transitional Provisions**)¹.

Background

The Commission completed a review of the GDP Applications and made indicative decisions for the purposes of consultation for each GDP at the 29/30 November 2005 and 20/21 December 2005 Board meetings, and a consultation paper was published on 22 December 2005².

At the same time, the Board also decided to seek further information from Transpower on a number of points in respect of both Applications. This further information was requested on 16 and 22 December 2005 for the 31 October Application and the 16 December Application respectively. On 1 and 7 February 2006, the Commission received further information from Transpower in respect of the 31 October Application.

¹ All references to a rule in this paper are to a rule in section III of part F of the Rules, unless otherwise stated.

² Entitled 'Assessment of Transpower's applications for interim grid expenditure dated 31 October and 16 December 2005.' <http://www.electricitycommission.govt.nz/consultation/gdpsconsult>

By the closing date of 8 February 2006, the Commission had received 11 submissions. The Commission has now considered those submissions and the further information provided by Transpower.

Approvals

At its meeting on 8/9 March 2006, the Commission Board:

- approved, in whole or in part, amounts of interim grid expenditure for GDP projects 1, 2, 3, 4, 5, 6, 7, 8 and 11; and
- declined to approve the interim grid expenditure for GDP 9.

Full details of the amounts approved are set out in the table contained in the appendix to this letter. The Commission considers that any amounts of interim grid expenditure approved under rule 16 would be the maximum amount on which customer charges could be based and, as such, customer charges would be based on the lesser of the approved amount or the actual nominal cost of the project at the time of commissioning (i.e. the capitalised book value).

The Board made special resolutions in respect of two projects, GDP 1 and GDP 10. Details of those special resolutions are set out below:

GDP 1

GDP 1 comprises the installation of a 100 MVar Static VAr Compensator (**SVC**) at Albany and the installation of a Reactive Power Controller (**RPC**).

The Commission has approved up to \$24.5 million of interim grid expenditure for the installation of the SVC. This figure is based on the mean of the three quotes that Transpower provided in its response of 1 February 2006, plus a contingency sum.

In its letter of 16 December 2005, the Commission asked Transpower to further elaborate on the scope of the RPC and the Commission appreciates the draft paper that Transpower provided in response to that request. However, the Commission considers that the information supplied to date does not lead the Commission to be reasonably satisfied that the amount, proposed for the installation of the RPC, meets the requirements of rule 16.2.3.1 at this time.

The Commission notes that management of reactive power in the Auckland area will be increasingly important for maintaining grid security in future years, and that the investigations Transpower is undertaking into the scope of the RPC over the next 12 months are essential. The Commission would like Transpower to investigate the benefits of different RPCs and provide further information to the Commission on the cost and benefits of various options as its investigations progress.

In order to ensure Transpower is able to carry out these investigations and preliminary design work, the Commission has approved up to \$1.5 million of interim grid expenditure. However, it has deferred its consideration of approval of the remaining interim grid expenditure applied for on this RPC until Transpower has completed its investigations to better define scope.

Therefore, in total, the Commission has approved an amount of up to \$26 million of interim grid expenditure for GDP 1.

GDP 10

GDP 10 comprises the construction of a new 220kV switching station at Huntly East, near the deviation of 220kV Otahuhu-Whakamaru C, that connects to the existing Huntly substation.

The Commission's analysis agrees with Transpower that this is an urgent reliability investment that needs to be implemented as soon as possible. However, the Commission is concerned about Transpower's cost estimate for the project. The Commission considers that the estimate provided by Transpower may have included larger contingency sums than Transpower would normally have applied, due to Transpower's understandably rapid preparation of this urgent proposal.

Therefore, the Commission would like Transpower to agree to provide a more refined cost estimate after it has completed further investigations and design work for the project. The Commission understands that this may take some time. Consequently, in order to enable approval as soon as possible, the Commission Board has delegated to me the authority to approve the appropriate amount of expenditure on the project after receiving Transpower's agreement to provide a refined cost estimate at a future date.

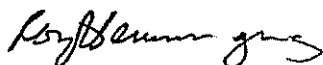
The Commission considers that the amount of interim grid expenditure approved under rule 16 for GDP 10 would be the maximum amount on which customer charges could be based and, as such, customer charges would be based on the lowest of Transpower's current cost estimate, Transpower's refined cost estimate, or the actual nominal cost of the project at the time of commissioning (ie the capitalised book value).

The Commission intends to publish a document containing a commentary on submissions received and the reasons for its decisions on the GDP Applications, in the next few weeks.

In accordance with rule 17.3 of section III of part F of the Electricity Governance Rules 2003, the Commission has advised the Commerce Commission of its decisions in respect of the GDP Applications.

Please do not hesitate to contact me directly should you wish to discuss the issues raised in this letter in further detail.

Yours sincerely



Roy Hemmingway
Chair

cc: Howard Cattermole
Tim George

Appendix – Table of GDP Projects and approval amounts

	Description	Approval requested from EC (\$m)	Start	Finishing	Approval category	Amount approved (\$m)
GDP 1	Reactive support in the Upper North Island: – 100 MVAR SVC at Albany (including RPC)	39.4 (total for GDP1-3)	2005	2007	C/A	26.0
GDP 2	– 100 MVAR capacitor bank at Albany 220kV				A	3.4
GDP 3	– 24 MVAR capacitor bank at Kaitaia				A	2.6
GDP 4	Thermal upgrade of the 220kV Otahuhu-Whakamaru 1 and 2 circuits	13.5	2006	2008	A	13.5
GDP 5	Enhancement of the transmission network in the Bay of Plenty as follows: – New switching station at Hairini – New 25 MVAR capacitor bank at Tauranga – Reconductoring the 110kV Hairini-Tauranga transmission line	15.8	2006	2008	A	15.8
GDP 6	Replacement of 220/110kV interconnecting transformers at: – Kikiwa and	9.2	2006	2007		9.2
GDP 8	– Stoke				A	

	Description	Approval requested from EC (\$m)	Start	Finishing	Approval category	Amount approved (\$m)
GDP7	220kV bus security upgrade at Kikiwa	4.2	2005	2007	A	4.2
GDP9	Reconductoring the 220kV Aviemore-Waitaki-Livingstone circuits	14.3	2006	2008	D	0
GDP10	A new 220kV switching station at Huntly East	\$33.5	2005	2008	A	TBC
GDP11	30 MVAR capacitor bank at Bombay	\$1.8	2005	2008	A	1.8
	Total	\$131.7	2005	2008		76.5 (to date)