



Part F Briefings October 2004 – Questions

This document covers some of the questions that were asked during the Commission's recent briefings held in Wellington, Auckland and Christchurch.

The briefings covered an introduction to the Commission and its responsibilities and an outline of the work in progress on Part F, including current consultation.

Wellington – Monday 4 October 2004

1. What commonality is there between the regulatory regimes in NZ and Australia?

The main commonality is the Regulatory Test, of which the second version in Australia has just been published.

The main differences are that the Australian regime has no nodal pricing except between states or regions; it has both economic and reliability investments in the grid and it has various regulatory bodies which appear to have overlapping jurisdictions. For example, it has both state regulators and federal/ national/ regional reliability committees. The New Zealand set up is much simpler.

2. The Grid Investment Test (GIT) is a key part of the process and the Statement of Opportunities (SOO) is published for information only – but the SOO references the scenarios to be used when applying the GIT; therefore, is the SOO not actually much more important than just being published for information?

In the SOO, we wanted to publish and consult on the scenarios used in applying the GIT so that any investments are compared against the same scenarios.

3. Will participants be able to access the databases and models that the EC is using and how transparent will this be?

The Centralised Data Set (not covered by this presentation) will include historical information. Associated with this will also be a central source of Part F planning information. The Commission will be consulting on the content shortly which is likely to include the inflow sequences, the work used for the SOO, the demand forecast, etc.

4. Regarding the structure and counterparties work, how much does the Commission intend to use incentive based regulation as opposed to a contractual approach?

Part F has a contractual approach so the Commission is bound to follow this. However, the contract counterparties paper, out for consultation at present, proposes the idea that any participant with a legitimate commercial interest can contract with Transpower, and the Commission asks whether this approach results in such a complex set of contractual arrangements that it is not viable.

5. Given the amount of resources committed by Transpower in its grid planning process, what level of resources does the Commission believe is required by others to look at non-electrical alternatives?

As described in its consultation papers out at present, the Commission sees that there are various types of alternatives, including those which may not have a proponent. However, the alternatives to be considered must be reliable and fairly certain at the time the final grid upgrade approval decision is made. The Commission intends to follow a phased approval process; this allows more time

for alternatives to be investigated and proposed at different stages in the approval process.

6. How does the Commission intend to regulate for sustainability?

The Government Policy Statement (GPS) contains a responsibility on the Commission to achieve sustainability. The Commission has a specific budget for an energy efficiency programme and the Commission will be putting out an RFP in the next few weeks to request assistance with this programme.

7. If the Commission has a specific energy efficiency workstream, where does it fit with Part F and where does it fit with the economy as a whole?

It's a question of access to data and experience, and of understanding what energy efficiency potential is out there. In New Zealand, we have little experience of direct investment in energy efficiency programmes. The Commission is undertaking some pilot energy efficiency programmes now funded by the customer levy. These programmes may be expanded in the future, if they prove cost-effective as against new generation and transmission investment.

8. How will the pricing methodology under Part F mesh with the Commerce Commission threshold regime?

The Commerce Commission oversight with respect to Transpower continues until the government says otherwise through the legislation included in the Electricity and Gas Industries Bill (EGIB). The timing of any such transfer to the Electricity Commission will likely be different to any transfer of the lines companies' thresholds regime.

At present, Transpower must obtain approval from the Electricity Commission for any investments it wishes to make for which the costs will be passed on to participants via the pricing methodology. There are also transitional provisions under rule 16 of section III of Part F which allow Transpower to request approval for interim grid expenditure. Under these provisions, the Commission has six weeks to examine the request and grant approval (or not). If approval is granted, Transpower can then pass on the costs of the interim expenditure to participants.

Is there then the possibility for Transpower to make super profits, or to make losses (and so not cover its cost of capital), for any upgrades?

In terms of the profits, that is currently up to the Commerce Commission and whether they decide to reduce Transpower's thresholds if this becomes an issue. In terms of the losses, if Transpower goes over its approved costs when implementing its investment plans and it does not obtain approval of further costs from the Commission, then, yes, there is certainly the possibility that Transpower will not recover its costs.

If the question was really – has the Commission made any progress on its Memorandum of Understanding with the Commerce Commission? – then, the answer is yes, it has made some progress, but the focus has been on continuing work in other areas at present.

- 9. Will there be some co-ordination of pricing products – the pricing guidelines require the pricing methodology to link into the FTR design, there are proposals being discussed for a day ahead market and the hedge market development steering group met recently – is there a mechanism for a holistic / integrated whole?**

There will not be a strong linkage between transmission pricing and FTRs based on the Commission's current proposal. The main issue is what to do with the loss and constraint rentals. This will be dependent on future decisions on FTRs.

- 10. The SOO will contain a series of fuel based scenarios – why is there no generic scenario based on demand side initiatives, etc?**

The purpose of Part F is to look at transmission investment. We need a robust approach to test such investment, hence the five scenarios proposed. The SOO is not about planning generation for 20 years – each scenario will have different alternatives and the SOO/GIT will provide a framework to develop the means to consider demand efficiencies.

- 11. Will the Commission factor in the ability to switch gas between contracting parties?**

The scenarios are based on physical possibilities rather than contractual positions – we will put modelled generators in different places but, as they are hypothetical, they could be owned by any party.

- 12. How are the benefits of the separate projects calculated? Are the benefits confined to the electricity industry?**

The scope of the GIT as defined in Part F covers the benefits within the electricity industry only. The real options analysis or standard Net Present Value (NPV) can be used. Standard NPV analysis methods do not easily recognise the value of flexibility.

- 13. Diversity gives a certain robustness and security – is there any way of putting this in the analysis?**

This is done by making the Grid Reliability Standard (GRS) an economic standard and by assigning probabilities to levels of reliability; in doing so you can factor in the benefits from less reliable elements.

Auckland – Thursday 7 October 2004

- 1. How can the work on the Grid Upgrade Plan (GUP) and the Pricing Methodology take place at the same time?**

The pricing methodology guidelines will provide an overview of how the methodology should be structured, but the actual detail of prices will not be known until after the pricing methodology itself is completed. Grid Upgrade Plan consultation could use approximate prices consistent with the pricing

methodology guidelines. Actual prices differ from year to year anyway; knowing the exact price is not as important as knowing how the price is structured.

2. Are draft benchmark agreements mandatory?

Yes, the development of benchmark agreements is mandatory under Part F and transmission agreements signed between Transpower and customers should be consistent with benchmark agreements. If Transpower and particular customers are unable to agree on a transmission agreement themselves, the benchmark agreement kicks in as the default transmission agreement.

3. How much in the benchmark agreement is common (i.e. effectively a regulation) and how much applies to particular customers in a particular place?

The preliminary consultation paper out at present includes the Commission's thinking about allowing customers to have a relationship with Transpower which allows customers to hold Transpower accountable for the delivery of services.

The Commission is also developing Use of System agreements and model contracts for the distribution area. This work is being led by Robert Reilly, the Commission's Senior Advisor, Retail.

In some countries, the accountability for the delivery of transmission services is managed via regulation and tariff; in New Zealand, we have chosen to do this by contractual arrangement.

Christchurch – Friday 8 October 2004

This briefing had much more of a general discussion on the issues raised; not all of that discussion is reflected here.

1. There is very little information on FTRs – what level of priority is the Commission placing on the development of FTRs?

The main case for FTRs now comes from the electricity market itself (i.e. the need for locational energy hedges) rather than as an aid to investment in transmission. The Commission has a requirement under Section V of Part F to deliver a progress report by 30 June 2005 – this report is likely to be an outline of the development plan going forward.

There have been no detailed requests from market participants for the development of FTRs and, although the Hedge Market Development Steering Group (HMDSG) may wish to consider FTRs as part of their work plan, the Commission has asked that the group give priority to the work on ordinary hedges first.

2. Aren't FTRs something that a distributed generator should argue for?

A distributed generator gives customers a more guaranteed path to the grid, because such a node would not be so subject to constraints, but the generator could end up paying for FTRs.

It was pointed out that it would need to be a fairly sophisticated distributed generator which argued for FTRs.

The extent to which transmission pricing is an influencing factor in behaviour is a big issue for debate and one which the Commission has discussed at length. How much can 10-20% of the delivered cost of electricity influence where generation or load is placed? The Commission would be keen to receive participants' views on this issue.

3. If a private investor creates a social benefit by placing new generation in an area of congestion (and therefore, by implication, high nodal prices) this tends to result in a reduction in the nodal price. This means that the social benefit of the investment is not recognised, and the private investor then loses out as the nodal price drops. How does this situation encourage private investors to fund new generation schemes in areas of high nodal prices?

This does accurately describe the way that the nodal price set up works, but this is simply a reflection of how competition affects the price of a good or service, and the subsequent impact on price of an increase in the supply of a good or service. The electricity market in New Zealand is, after all, set up to work as a market, and markets in other goods and services produce the same phenomenon.

4. What information on fuel costs will be incorporated into the generation scenarios?

The Commission will seek expert advice on future fuel costs and publish these as part of the SOO.

5. Can you explain more about how the Grid Reliability Standards will be an economic standard?

If a particular location is not maintaining n-1 security, the cheapest means of achieving n-1 security again (by investing in transmission or alternatives) will be compared against the cost of not supplying that load. This may lead to a reduction in the level of reliability in that area if it is uneconomic to maintain n-1, although in many cases reliability will improve if a lower cost alternative is viable instead.

6. To what extent will Transpower be required to look at alternatives?

The application of the Grid Investment Test requires alternatives to be considered. Throughout the course of its deliberations, the Commission has

established that there are different standards of alternative (for example, committed, anticipated, without a proponent, etc).

Transpower has recently released a Request for Information document about proposals for alternatives in the Auckland and North Isthmus area which would be considered alongside its proposals for transmission investment between Auckland and Whakamaru.

The Commission may decline to approve a grid upgrade plan investment if it finds there is a more cost effective alternative.

7. Isn't the management of load at a local level actually a way of reducing the need for investment?

Historically load management has been effectively used as a successful way of reducing the need for investment. This should be continued in future. However, there is a difference between load management for a few hours per year and load management for many hours per year, in which case transmission or generation investment becomes more critical in the eyes of participants.