

Overview: Transmission Pricing Review Project

1. Introduction

The Electricity Commission (**Commission**) has initiated a review of transmission pricing (**review**). The review will consider options for the allocation methodology for transmission costs. The review will include consultation with interested parties and economic, technical and legal analysis of the options being considered.

The Commission anticipates that the review will be wide-ranging enough to consider a variety of allocation approaches that have been suggested by interested parties in past consultations. In order to include the breadth of options, and ensure thorough analysis, the Commission is planning possibly three analysis stages. Each stage will include an issues paper for consultation with the final issues paper planned for the end of 2010.

The Commission expects that any subsequent changes to Transpower's Transmission Pricing Methodology (**TPM**) will be effective from the 2012 pricing year. This will coincide with the approximate commissioning dates of a number of significant investments and will therefore be in step with changes in the rate base and consequential pricing impacts.

The Commission recognises that, as it is an allocation methodology, the different options being considered may change how much different parties are charged for transmission services. For this reason the Commission will encourage strong input from interested parties into the review. As well as written submissions, the Commission expects to provide opportunities for input through conferences and/or briefings as the review progresses.

The Commission is also inviting nominations for a working group to provide technical advice (**Transmission Pricing Technical Group**). This group will be made up of technical specialists from interested parties and will provide specialist review and input into the Commission's transmission pricing review project (**project**). The group will work within the scope and objectives of the review. The Commission expects to appoint consultant(s) to provide specialist economic and technical investigations and legal advice.

2. The scope of the review

The review will be a comprehensive review of the allocation methodology used to recover Transpower's costs of providing transmission assets. The determination of the revenue requirement – rather than the allocation of the costs to transmission users – is regulated by the Commerce Commission under Part 4 of the Commerce Act 2006, and is not subject to this review.

The following table outlines the areas of transmission pricing and related areas that will be part of the review (included in the scope) and for clarity those that will not (excluded from the scope).

Included in the scope of the review: (We will do this)	Excluded from scope of the review: (We won't do this)
<ul style="list-style-type: none"> Review options for pricing to recover costs of providing grid owner assets in the context of the existing Pricing Principles. The assets include both existing and new assets that are proposed in Grid Upgrade Plans (GUP) and approved. 	<ul style="list-style-type: none"> Review Transpower's revenue requirement. This is the responsibility of the Commerce Commission. Review the valuation methodology used for Transpower's revenue requirement. Review pricing for System Operator services. Review pricing for input connection contracts, new investment agreement contracts, notional embedding contracts and new investment contracts¹. (Although it is noted that operational and maintenance costs for new investment contracts are allocated via the TPM.)
<ul style="list-style-type: none"> Review options for pricing to signal long-run and short-run costs. These options will include who is allocated charges and what factors are used to determine the levels of the charges such as which assets are used to deliver energy, the location on the network, the total energy injected or withdrawn from the network, peak injection or offtake, what time of day energy is used or supplied or other possible factors. This will include reviewing options for locational transmission price signalling. There are some existing mechanisms which result in locational signals to transmission users; nodal pricing (with the allocation of loss and constraint rentals) and the Grid Investment Test (GIT). The review will consider whether further locational signalling through transmission charges is efficient and practicable alongside these existing mechanisms and whether these mechanisms efficiently signal transmission costs. 	<ul style="list-style-type: none"> Review counterparties for transmission connection. Review service levels. <p>(These have been reviewed under the Benchmark Agreement).</p>

¹ Contracts as defined in Part A of the Rules.

Included in the scope of the review: (We will do this)	Excluded from scope of the review: (We won't do this)
<ul style="list-style-type: none"> Review options for both fixed and variable elements of transmission pricing. 	
<ul style="list-style-type: none"> Review options for avoiding inefficient bypass of the existing grid. 	
<ul style="list-style-type: none"> Review cost allocation method for investments in transmission alternatives. 	
<ul style="list-style-type: none"> Review charges to recover costs of reactive power support. The Commission has indicated in its response to submissions on its consultation on <i>ensuring efficient reactive power investment</i> and the options to achieve this, that it would explore more fully the administered charge option in the upcoming transmission pricing review. Of all the options discussed in the consultation paper most submitters appeared to support some form of reactive charge as part of the TPM. 	
	<ul style="list-style-type: none"> Review the process outlined in Part F, Section IV, rules 5 to 11 for development and approval of the pricing methodology.
<ul style="list-style-type: none"> Review the role of transmission pricing in driving efficient outcomes in the wholesale electricity market; its impact on other parts of the market and the impacts of other parts of the market on transmission pricing. This will include the role of transmission pricing in encouraging load management and electricity efficiency and encouraging renewable generation connection to the grid. 	<ul style="list-style-type: none"> Review energy market rules.

3. Relationships with other aspects of the electricity market

There are relationships between transmission pricing and other aspects of the electricity market from an economic policy point of view, from a practical and technical point of view and from a legal point of view.

The review must give regard to these relationships to ensure the overall outcomes are consistent, or appropriate trade-offs are made. In some cases the review will need to coordinate with other Commission workstreams such as the market design review.

Whilst other parts of the Electricity Governance Rules 2003 (**Rules**) are outside the scope of this review, the project must ensure its outcomes are consistent with all other parts of the Rules, or recommend changes. This might, for example, include; Common Quality (part C) Trading Arrangements (part E) and Grid Upgrade and Investments (Section III of part F).

The project will also need to coordinate with either existing advisory groups or proposed new advisory groups.

4. Objectives

The aim of the review is to determine a preferred option for transmission pricing that must meet the following objectives:

- Be consistent with the Commission's principal objectives and specific outcomes as stated in the Electricity Act 1992.
- Be consistent with the Government's policy for the pricing of transmission services as stated in the Government Policy Statement (**GPS**).
- Be consistent with the pricing principles as stated in Part F of the Rules.
- Take into account practical considerations.
- Take into account transaction costs; the preferred high level option should not incur unreasonable transaction costs.
- Take into account the desirability for consistency and certainty for both consumers and the industry.

5. Description of project

The Commission expects to undertake three analysis and consultation stages; the first a review of high-level options, the second an analysis to identify a short list of options, and finally a detailed evaluation of a preferred option for transmission pricing. At each stage the Commission expects to publish an issues paper and undertake public consultation.

If the preferred option is a new transmission pricing option, the Commission will publish an issues paper detailing the preferred option and draft pricing guidelines that Transpower will follow in developing its TPM. If the preferred option leads to significant changes in charges to participants, the review will consider options for transitional arrangements, noting that one of the objectives for the review will be consistency and certainty.

The project has been structured into a project set-up stage followed by three review and analysis stages as set out below. The timeframes below are approximate and may be subject to change.

Transmission Pricing Review Project with timeframes

