

TRANSPower NEW ZEALAND LIMITED

Cross Submission on Submissions Received on the
Electricity Commission's Benchmark Agreement
and Interconnection Rules Consultation Papers

September 2006

T R A N S P O W E R



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T R A N S P O W E R



1. Introduction

1.1 Purpose of this document

This is Transpower's submission in response to the Electricity Commission's paper dated 30 August 2006, inviting cross submissions on submissions received by the Commission on the following two consultation papers:

- *Benchmark agreement consultation paper and draft benchmark agreement, 19 May 2006*
- *Interconnection rules consultation paper and draft interconnection rules, 9 June 2006.*

1.2 Content of the submission

The Commission has indicated that it is particularly seeking cross submissions on the following:

- the types of service measures and levels;
- compensation and liability, in particular whether these should extend to the coverage of indirect costs, the level of any liability caps, and the extent to which an unconditional service guarantee can and should be considered as being feasible at this or a later time;
- the Commission's proposal for developing an Outage Protocol covering connection and interconnection assets;
- the Commission's proposal that technical disputes under the Benchmark Agreement be considered by the Rulings Panel;
- the Commission's proposal for rule changes relating to consistency with the Grid Reliability Standards, and particularly issues raised by submitters relating to disputes between connected parties and Transpower regarding the level of reliability provided by connection assets.

The Commission has sought comment on the following two options as alternatives to referring technical disputes under the Benchmark Agreement to the Rulings Panel:

- a. status quo as per the existing rules: the Rulings Panel would have no jurisdiction as to the interpretation or enforcement of the Benchmark Agreement (rule 6.3.2 of section II of Part F); or
- b. provide that the Rulings Panel should be available as the final dispute resolution for all disputes (both technical issues and issues

relating to other clauses of the Benchmark Agreement). Other dispute resolution options under the Benchmark Agreement would continue to be available.

The Commission has also sought comment on the following possible approach to giving counterparties greater decision-making rights with respect to investment in connection assets:

- a. If Transpower identifies that connection point capacity is likely to fall below the N-1 criterion, Transpower would be required to investigate whether the connection assets meet the Grid Reliability Standards and, if not, develop alternative proposals to enable the connection assets to meet the Grid Reliability Standards, and propose these alternatives to the counterparty under any transmission agreement that applies to that asset.
- b. Transpower and the counterparty be given six months to agree on whether to invest or take some other action, subject to complying with rule 5 of section II (if it applies).
- c. If no agreement is reached within six months:
 - (i) The counterparty could either carry out investment itself, contract with a third party to do so or take some other action to address the situation, as it sees fit, subject to complying with rule 5 of section II (if it applies) and good electricity industry practice (e.g. in terms of the engineering and technical implications of its proposal);
 - (ii) If the counterparty or a third party carries out an investment, Transpower could be required to provide access to its land for the purposes of that investment. This will require changes to the access and occupation schedule in the draft Benchmark Agreement;
 - (iii) Transpower would be able to dispute under the Benchmark Agreement whether the designated transmission customer's proposals under (i) complied with good electricity industry practice.

This option would require an amendment to the GUP process in section III of Part F of the Rules to prohibit Transpower from applying for a GUP for the connection assets if the counterparty did not agree.

The Commission has sought views on whether or not customers should be given the opportunity to specify their own Value of Lost Load (VoLL) for use in applying the Grid Reliability Standards to connection assets. This could be achieved by providing in the Benchmark Agreement and in rule 5 of section II that, for the purposes of connection assets, the value of unserved energy (i.e. the VoLL) would be determined by the counterparties. The VoLL to be applied under the Grid Reliability Standards when calculating reliability benefits of an economic reliability investment would recognise the specific situation of the end-use

customers served by those connection assets. This value would be determined by the counterparty, acting reasonably, under the Benchmark Agreement and reviewed by the Commission under rule 5 of section II.

Under this approach, direct regulatory oversight of the bilateral connection arrangements would seem to be limited, with the Commission's involvement only under rule 5 (as currently provided for) and through the Rulings Panel. The Rulings Panel would be involved if a breach of rule 5 is alleged (if the breach process proceeds that far) or when the parties cannot resolve a dispute.

This submission also contains Transpower's comments on a range of issues raised by other industry participants in the first round of consultation.

2. Executive summary

2.1 Key Points

Transpower confirms the points made in its original submissions on the draft Benchmark Agreement and Interconnection Rules, in particular the following:

- a. Transpower and the Commission should work together to finalise the service measures once the consultation has been completed, in order to ensure that the measures are clearly defined and practical and that duplication is avoided.
- b. Legal liability under the Benchmark Agreement should be limited to direct costs and capped at \$5million per event and \$20million per annum for all events. Further extending Transpower's legal liability would create a "moral hazard" problem and inappropriately allocate the economic incidence of negative events, because it would result in a substantial proportion of the cost of these events being recovered from parties that are not able to manage the risk of such events.
- c. The Outage Protocol should be guided by a set of objectives and managed on a voluntary basis, as is successfully done at present. Regulating the process in the detailed and prescriptive manner contemplated by the draft Interconnection Rules is likely to produce an outcome that is rigid and inflexible and, in practice, more costly.
- d. Transpower disagrees that transmission customers with a long-term credit rating equal to or better than BB (or equivalent) on the Standard and Poor's rating scale should be entitled to have credit extended to them by Transpower without credit support. However, a BBB credit rating threshold would be acceptable. Because a BB rating has significant speculative characteristics, setting the threshold

at this level would add to Transpower's costs and consequently increase transmission charges to all customers, i.e. the financial impact would be inequitably shared, because some of the additional costs created by customers with low credit ratings would be borne by customers with higher ratings.

In relation to the two additional questions that the Commission requested submitters to consider at paragraphs 22 to 29, Transpower submits as follows:

- a. Transpower agrees with the option proposed by the Commission at paragraph 22a that the Rulings Panel should have no jurisdiction with respect to the interpretation and enforcement of the Benchmark Agreement. The Panel does not have sufficient technical experience and expertise to resolve a range of technical disputes.
- b. Transpower agrees with the Commission's proposals at paragraphs 25a and b that Transpower investigate and develop proposals for connection assets to meet the GRS and that Transpower and a counterparty be given six months to agree on an investment.
- c. However, Transpower strongly disagrees with the Commission's proposal at paragraph 25c that if no agreement is reached between Transpower and a counterparty, the counterparty may carry out the investment itself on Transpower owned land, and that Transpower would be obliged to permit the counterparty to locate and have ongoing access to the investment on Transpower's land. This is completely unacceptable for safety, operational and environmental reasons and unreasonably restricts Transpower's use of its own land.
- d. With respect to the proposal at paragraph 27 that connected customers be permitted to specify their own value of lost load (VoLL) for the purpose of evaluating possible investment in connection assets, Transpower disagrees in relation to distribution companies, and in relation to generators and direct connects that share connection assets with other connected parties. This is because, for distribution companies, the VoLL estimated by a distribution company may not fairly reflect the mean VoLL of the company's customers. This problem may also apply where a generator or direct connect shares connection assets with other parties. (Whether or not the VoLL figure to be applied should be the mean VoLL or the highest VoLL of any party connected at a particular grid connection point or any customer of such a connected party is another contentious question that is yet to be resolved.)

3. Discussion

In the areas where the Commission has indicated that it has sufficient information, Transpower reconfirms the positions adopted in its original submissions and the arguments made in support of those positions, in particular:

- Requirements relating to interconnection asset services should be included in the Rules and the Benchmark Agreement should cover connection services. However, given the inevitable relationship between connection and interconnection assets, the Commission must ensure that the development of the contractual and regulatory framework is co-ordinated effectively (section 4.3 of Transpower's submission to the Electricity Commission on the Benchmark Agreement consultation paper and draft Benchmark Agreement, July 2006).
- A single transmission agreement should cover connection services and interconnection information services (section 4.3 of Transpower's submission to the Electricity Commission on the Benchmark Agreement consultation paper and draft Benchmark Agreement, July 2006).
- The counterparties to the Benchmark Agreement should be the physically directly connected parties (section 4.5 of Transpower's submission to the Electricity Commission on the Benchmark Agreement consultation paper and draft Benchmark Agreement, July 2006).
- Transpower accepts the concept of the proposed asset availability approach to defining grid services, but has substantial concerns about the detail of the proposed measures (section 4.7 of Transpower's submission to the Electricity Commission on the Benchmark Agreement consultation paper and draft Benchmark Agreement, July 2006).

As a general point, Transpower continues to be concerned that the overall framework needs to be fully developed and subjected to consultation before it is finalised. Not to do this would risk creating significant inconsistencies between the various inter-related elements of the Benchmark Agreement (BA) and Interconnection Rules (ICRs) and consequent operational difficulties.

The following comments respond to the issues on which the Commission has sought particular comment and discuss a number of points raised by the other industry submissions.

3.1 Service measures and levels

Transpower agrees with the categories of service measures proposed, and the Commission's proposals relating to enforceability, but submits that the measures must be more clearly defined. Transpower notes that there is a substantial degree of duplication between some of the

measures proposed and information already provided by other means and submits that duplication should be eliminated or minimised. The Commission must ensure that both of these concerns are addressed. These issues are canvassed in detail in Transpower's original submissions.

Transpower also proposes that once the Commission has established what it considers to be the near final range of measures, based on the submissions it has received, the Commission should then work with Transpower to finalise the measures in detail. This approach would help ensure that the measures were appropriately defined, and duplication minimised.

Other submissions

The list below sets out a number of points raised by other submitters (in italics), and Transpower's responses.

Market measures should be developed, possibly based on the value of constraint rentals

Transpower Response

Transpower understands the desire for market measures. However, the Commission and industry participants must appreciate that any market measures are likely to measure overall market performance, not just Transpower's performance.

There is no definitive rationale for the constraint rental based market measure proposal. Because of the low price elasticity of demand for electricity, constraints generally produce close to a zero sum overall market outcome, with very little "deadweight loss", i.e. some generators and retailers will benefit from a constraint and others will lose, with no clear relationship between the value of the rentals and net economic loss. In some instances, it is possible for particular market participants to exercise market power by engineering constraints for their own advantage. It is not reasonable for Transpower to be penalised for such behaviour.

Constraints may result from the need for investment which is outside Transpower's control (and in the control of the Electricity Commission). Again, it is neither equitable nor efficient for Transpower to be penalised in these circumstances.

Another possible market measure is the number of constraints that bind during transmission outages or, even more simply, how many constraints bind each year. Again, such measures can be strongly affected by the behaviour of market participants and decisions by the Electricity Commission to approve or withhold approval for investments. These factors are clearly outside Transpower's ability to control.

In general, market measures would be complex to develop and unlikely to produce conclusive outcomes. Transpower submits that they are not a practicable option at this point.

All service measures should be enforceable

Transpower Response

It is inequitable and inefficient for availability and reliability measures to be enforced by financial sanctions when no damage has occurred. Where damage has occurred because of an outage, the liability and compensation provisions apply. (See below at page 12 for a discussion of “moral hazard” and the economic incidence of compensation payments in relation to direct and indirect costs.)

Measures should be output-based not input-based

Transpower Response

Making measures output-based is more consistent with the “meet demand” approach to service delivery, which the Commission has rejected, rather than the “asset availability” approach. It is not a reasonable basis for the development of service measures as Transpower does not, under the current rules, control the investment needed to meet such measures.

Capacity services should not be based on the nameplates of equipment – asset owners should set the ratings

Transpower Response

Transpower agrees with this suggestion, which supports the use of the Asset Capability Statements to establish asset capacities, rather than simply using the nameplate capacity (as the draft Interconnection Rules and Benchmark Agreement provide). The Asset Capability Statements take account of assets’ nameplate capacities, but also use other information relevant to the capacities of the assets.

3.2 Legal liability and compensation

Transpower reconfirms the points it made on liability and compensation in its submissions on the BA (section 4.8) and ICRs (section 4.9); in particular, that:

- a. Liability under the BA should be limited to direct costs (but not abatement of transmission charges for interruptions) and capped at \$5 million per event, and \$20 million in any twelve month period for all events;
- b. No further consideration should be given to the unconditional service guarantee and voluntary insurance approaches. There are legal impediments to the former, and both approaches are inconsistent with the regulatory framework and principles required for Benchmark Agreements contained in Part F;
- c. Compensation under the ICRs should only be available to designated transmission customers rather than to all participants, as the latter approach would entitle those

participants who do not pay for transmission services to free ride on those who do;

- d. Transpower should be relieved of its obligations under the ICRs in circumstances of force majeure; and
- e. Liability under the ICRs should be limited to direct costs.

Other submissions

The discussion below sets out a number of points raised by other submitters, along with Transpower's responses.

There should be no caps on liability

There should be an unconditional service guarantee

Indirect as well as direct costs should be recoverable in all cases

Compensation should be charged to Transpower's shareholder account, rather than recovered through the revenue requirement

Transpower Response

Transpower disagrees with each of the above proposals. Transpower submits that, firstly, they create a "moral hazard" problem and, secondly, they raise an economic incidence issue.

The moral hazard problem refers to the fact that tolerance for risky behaviour can increase (inappropriately from the perspective of the community as a whole) if a particular person or firm is sheltered from the results of that behaviour. Transmission customers may not do all that they reasonably and economically should to manage the risk of service failure if they believe that they will suffer no ill effects should failures occur. The risks of many indirect costs are best able to be managed by transmission customers, not Transpower. Therefore, it is economically sensible for the transmission customers to bear those costs should they eventuate.

The economic incidence of a cost refers to who ultimately bears the cost of a negative event. Because Transpower is a regulated entity, costs that it incurs are ultimately borne by the industry as a whole. This is recognised in section IV of Part F, which provides that the purposes of the transmission pricing methodology is to ensure that, subject to Part 4A of the Commerce Act 1986, the full economic costs of Transpower's services are allocated in accordance with the pricing principles. The costs to Transpower of complying with the compensation and liability regimes established under both the BA and ICRs are economic costs which will form part of its revenue requirement and be allocated to customers in accordance with the transmission pricing methodology.

The suggestion by some submitters that Transpower's shareholder, the Crown, should bear the cost of compensation is contrary to the regulatory framework and would mean that the ultimate incidence of the

cost would be borne by the community as a whole. Hence, if Transpower's liability is not capped, is made unconditional, or is extended to indirect costs not currently covered, the economic incidence of negative events will be spread widely, either across the electricity industry or possibly across the community as a whole. This again represents a "moral hazard" and an allocation of risk that will produce perverse incentives, because those who are in the best position to manage the risk of the negative events will not bear most of the cost of those events when they occur.

In relation to the unconditional service guarantee, Transpower reiterates its view that this cannot be legally implemented, whether under the BA or the ICRs. Further, it is inconsistent with the principles for Benchmark Agreements set out in rule 4.2 of Section II of Part F, as well as the regulatory framework. Transpower also notes that there are no known international examples of substantial unconditional service guarantees applying in comparable industries.

Caps should be customer specific, related to the potential level of loss and increased on a regular basis/linked to network criticality and size

Transpower Response

While in principle a customer-specific approach to liability caps is possible, the process required to establish an appropriate cap for each designated transmission customer would be time consuming, complex, costly and ultimately subjective. Transpower's view is that the caps should not, in any event, exceed those proposed by the Commission in the draft Benchmark Agreement, viz. \$5 million per event and \$20 million for all events in any one year.

In order to establish appropriate customer/Transpower caps (noting that the caps are reciprocal) the risks would need to be identified and consideration would need to be given to how, when and why those risks would arise, their likelihood and their magnitude. We note, in this respect, that the size of a customer's assets is not necessarily commensurate with the damage which could be caused by a counterparty to Transpower's assets.

An assessment of whether each identified risk needs to be addressed must be carried out, and options for addressing the risks developed. Only when all of these steps had been completed could liability be estimated and risk allocated (in accordance with the regulatory framework).

Finally, Transpower notes that the Rules do not provide for liability caps on a customer-specific basis, or differentiate in any other way the liability caps applicable to asset owners. Transpower submits that there is no reason for there to be a difference between the Benchmark Agreement and the Rules in this respect.

Transpower should be part of the Electricity and Gas Complaints Scheme

Transpower Response

From 25 September 2006, Transpower will become a member of the Electricity and Gas Complaints Scheme. Certain landowner and occupier complaints will be able to be laid against Transpower under that scheme from 1 October 2006.

Termination of services should not be a remedy for non-payment

Transpower Response

It is unreasonable and contrary to normal commercial practice for termination of services not to be a possible remedy for non-payment, in instances where non-payment is not related to matters in dispute. If Transpower were unable to terminate services for non-payment, there would be an incentive on counterparties to withhold payment of invoices. Transpower would always consider the possible impact on third parties of any decision to terminate services.

3.3 Outage protocol

Transpower's submission on the draft Interconnection Rules made the following principal points:

- The current voluntary outage planning process works effectively and should be retained.
- The net benefits test should be removed, as it will be difficult and costly to implement in practice and may produce perverse results by restricting the ability to modify the Outage Protocol in response to changing circumstances. A simpler test could achieve the benefits sought at significantly lower cost. Transpower has outlined a simpler test in its submission on the draft Interconnection Rules. Transpower's preference would be for an Outage Protocol based on a set of operating objectives or guidelines¹ rather than a prescriptive set of requirements and a net benefits test. The latter assumes more precision than is possible in practice and ignores the fact that outage planning and co-ordination are an iterative process that requires the application of judgment and experience.
- The technical parameters proposed in the draft rules for the preparation of the Outage Protocol are not practical.
- The timeframes for development and preparation of the Outage Protocol are inadequate.

¹ Possible guidelines could include:

- Avoidance of peak demand periods
- Avoidance of constraints, where possible
- Avoidance of outages that would reduce generation capacity
- Health and safety obligations to take priority over other objectives.

Transpower reaffirms these points.

Other submissions

Transpower has noted and considered the following points made by other submitters in relation to the Outage Protocol; these are discussed below:

The Outage Protocol should be "outcome focused" rather than "process focused" and should incentivise Transpower to minimise the economic impact of transmission asset outages

Transpower Response

The commercial impact of outages is relevant, but health and safety requirements (for both people and plant) must take priority and the practicality of any arrangements must be considered. All industry participants are aware that maintenance of assets must be undertaken and that this will inevitably involve some costs. In Transpower's view, the voluntary outage co-ordination process that currently operates has proven to be a successful approach, which effectively balances the interests of industry participants, and it should therefore be retained.

An industry working group should be established to develop the Outage Protocol, based on the market impact of outages and the process should be managed on a voluntary basis, similar to that for the Planned Outage Co-ordination Process

Transpower Response

As noted above, Transpower agrees that a voluntary process should be retained. This approach has worked effectively for years. Regulating the process in the detailed and prescriptive manner contemplated by the draft Interconnection Rules is likely to produce an outcome which is rigid and inflexible. Transpower would prefer to continue to work with the industry to ensure that an appropriate process was in place, and an industry working group would be a sensible means by which to achieve this.

Transpower does not believe that it would be practical or appropriate to develop the Outage Protocol based on the market impact of outages, for the reasons discussed under 3.1 above with respect to market measures generally.

Health and safety issues must be a priority

Transpower Response

Transpower agrees that health and safety issues are a priority. Achieving this objective may mean that outages must sometimes be scheduled at times that incur additional commercial costs.

Transpower should schedule planned outages in holiday and off-peak periods

Transpower Response

It is not always possible to schedule outages at off-peak and holiday times, for health and safety reasons, and for purely practical reasons, such as the physical availability of staff and equipment. This is regardless of the additional cost involved.

It should be noted that Transpower already actively seeks to minimise the impact of outages. While outages are scheduled several months out, and their details finalised six weeks out, Transpower still reschedules outages much closer to the outage time if unacceptable situations are predicted to occur. For example, outage planning for a critical circuit into any location involves real time operational meetings (usually by telephone) leading up to the outage time so that, should the situation change significantly for any reason (generation availability, load forecast etc.), outages can be rescheduled.

Query whether the Outage Protocol should be in Part F or Part C

Transpower Response

Transpower submits that the Outage Protocol (if it is to be included in the Rules at all) should be retained in Part F. The Outage Protocol is in the Interconnection Rules because it supplements the Benchmark Agreement, which will only apply to Transpower. The Interconnection Rules deal with interconnection assets and the Benchmark Agreement deals with the connection assets, both of which have to be "made available" under the service definitions and measures set out in the Benchmark Agreement.

Concern regarding the relationship between the Outage Protocol and the service measures, and the need for the Outage Protocol to deliver real benefits such as improved co-ordination of outages if the service measures as drafted are to be retained as they are

Transpower Response

Transpower is concerned that the proposed process for the development and application of the Outage Protocol, and the relationship between this and a precise set of service measures, is likely to result in an environment that will encourage Transpower to focus purely on achieving what is required by the Rules rather than endeavouring to modify its actions in response to changing circumstances in any particular instance (which ultimately would be more efficient and effective than strict compliance).

Both support for and concern about the net benefits test

Transpower Response

While Transpower notes that there is both support for and disagreement with the net benefits test, there are no substantial points made by other submitters which provide conclusive arguments in favour of the proposed form of the net benefits test. Indeed, it is acknowledged by other submitters that the test will increase Transpower's compliance costs, and that these additional costs will be borne by all connected customers. Transpower reiterates the views it expressed in its submission on the draft Interconnection Rules, that the complexity and inflexibility introduced by the proposed net benefits test is, perversely, likely to increase the total cost of outage management in practice. The concept seems appealing on the face of it, but its practical impact is likely to be very different from the theory. If there is to be a test at all, it should be a much simpler test which would achieve equivalent outcomes, but at significantly lower cost.

Transpower submits that the Outage Protocol should be guided by a set of objectives or guidelines (such as those described in footnote 1) and not be the outcome of a mathematical test. The latter approach is based on the assumption that the relevant costs and benefits can be estimated far more precisely than is possible in practice. In practice, judgment and experience must be used to assess a wide variety of interdependent, sometimes conflicting and uncertain factors.

If the Outage Protocol leads to reduced capacity, distribution companies may face financial losses as a result of stranded assets or the need to reconfigure their networks – such losses should be able to be recovered from Transpower under the rules

Transpower Response

Distribution companies are aware that planned maintenance on the grid is a necessary part of grid management, which creates some commercial costs, just as planned maintenance on the distribution companies' own networks does. This is an unavoidable part of the business and not an extraordinary event that warrants compensation.

Connected parties contract for services in relation to particular connection assets. For example, if a customer wants "n" supply, that customer must expect outages for maintenance on connection equipment and not expect Transpower to provide temporary generation during maintenance. Transpower maintains equipment based on good industry practice, but there will be always situations that occur outside the norm of this practice.

The Outage Protocol should be driven by customers' needs, even if this increases Transpower's costs

Transpower Response

All market participants are affected by the outage planning process and the current process ensures that all participants can make decisions knowing the commercial impact of those decisions. It should be noted that there are other factors which are also important (such as safety, system security etc.) and an overall balance of interests needs to be achieved.

The current Outage Protocol process aims to manage outages in order to minimise the overall impact of outages on all asset owners and the system operator in terms of its ability to meet its principal performance obligations.

The Outage Protocol should be in the Benchmark Agreement rather than the Rules

Transpower Response

Transpower's view is that the Outage Protocol, if it is to be regulated, is best placed in the Rules, rather than in the Benchmark Agreement. Given that the Outage Protocol applies to both connection and interconnection assets, it would be extremely difficult to reach agreement on the scheduling of outages affecting interconnection assets on a bilateral basis, under the Benchmark Agreement. In any event, the volume of outages would make this approach impossible to administer in practice.

Customers should determine when planned outages occur, not Transpower

Transpower Response

The current process enables all asset owners to influence the timing of the maintenance of grid assets that affect them, but, in practice, limitations on resources and the fact that more than one party (including the system operator) will usually be affected by planned maintenance, it is not always possible for maintenance to be undertaken at times that coincide with asset owners' first preferences. As noted above, the current voluntary arrangement works well in practice, and most asset owners have been satisfied by the overall outcome.

Outage planning should have regard to the impact of outages on wholesale electricity prices and seek to minimise binding constraints

Transpower Response

The current approach does have regard to the impact of planned outages on the electricity market. While constraints are avoided to the extent possible, the commercial impact of constraints often tends to

even out over time, as different generators and retailers benefit and lose as a result of constraints in different locations.

There should be further consultation on the Outage Protocol when it is developed

Transpower Response

Transpower agrees that there should be further consultation on all documents – the Benchmark Agreement, Interconnection Rules, the Connection Code and the Outage Protocol – once these are in final form. However, we point out that if the Commission accepts the approach proposed by Transpower for the development of the Outage Protocol in its submission on the draft Interconnection Rules, the need for consultation will be minimised, as industry participants will be involved in the development process.

3.4 Role of the Rulings Panel

Transpower reconfirms its concerns regarding the role of the Rulings Panel, including its proposed jurisdiction in relation to technical disputes under the BA. Transpower's view is that the Rulings Panel does not have sufficient technical experience and expertise to resolve a range of technical disputes. It is also not consistent with international practice for a regulator to be involved in the resolution of disputes between counterparties which are subject to its regulatory jurisdiction.

Transpower noted in its earlier submission that the jurisdiction of the Rulings Panel was too broad, especially given the Commission's proposal that the Rulings Panel determine variations to the Benchmark Agreement where Transpower and a counterparty cannot reach agreement. We remain of the view that this is inappropriate, and that rule 6.1.2 of section II of Part F confines the Rulings Panel's role to the resolution of disputes on requested variations to services under a Benchmark Agreement. This preserves the Commission's and the Minister's jurisdiction and governance responsibility for the terms and conditions of the Benchmark Agreement.

Transpower Response to the Commission's further issue regarding referral of disputes to the Rulings Panel

Transpower agrees with the Commission's proposal at paragraph 22a that the Rulings Panel have no jurisdiction as to the interpretation or enforcement of the Benchmark Agreement. Our view is that standard dispute resolution mechanisms enable the parties to a dispute to choose for themselves the most appropriate means of resolving the dispute, depending on the nature of the dispute, the issues involved and the requirements of the parties (for example, the parties may value confidentiality, flexibility, speed, limited appeal rights, minimum cost etc.). The means used should be a matter for agreement between the parties to the contract.

Transpower notes also that the Electricity Governance Regulations provide that a function of the Rulings Panel is to determine rule breaches, not breaches of contract.

3.5 Investment in connection assets in relation to Grid Reliability Standards

The Commission notes that a number of submitters have argued that the reliability of connection assets is a matter best left to bilateral negotiations between Transpower and counterparties and, in particular, that counterparties should be empowered with greater decision-making capacity in this regard.

Transpower Response

On this initial point, Transpower's view is that it may have a degree of validity, but only in cases where the counterparty is a direct connect or a generator that is not sharing assets with any other transmission counterparty. Where the counterparty is a distribution company, there is a risk that the distribution company, acting effectively as the agent for final consumers connected to its network, may not necessarily fairly represent the preferences of those final consumers (i.e. there may be a principal-agent problem). This may also be the case where generation customers share assets with other transmission customers. Accordingly, Transpower does not agree that investment in connection assets is always best left to bilateral negotiation between Transpower and transmission counterparties, or that counterparties should be empowered with greater decision-making capacity in this regard.

Proposed automatic right of access to Transpower land

Even in the case of a direct connect, or a generator that does not share connection assets, Transpower does not agree with the Commission's proposal at paragraph 25 of its discussion document that:

- c. If no agreement is reached within six months [between Transpower and a transmission counterparty]:
 - (i) The counterparty could either carry out investment itself, contract with a third party to do so or take some other action to address the situation, as it sees fit, subject to complying with rule 5 of section II (if it applies) and good electricity industry practice (e.g. in terms of the engineering and technical implications of its proposal);
 - (ii) If the counterparty or a third party carries out an investment, Transpower could be required to provide access to its land for the purposes of that investment. This will require changes to the access and occupation schedule in the draft Benchmark Agreement;
 - (iii) Transpower would be able to dispute under the Benchmark Agreement whether the designated transmission customer's

proposals under (i) complied with good electricity industry practice.

Transpower does not agree that connected parties should have automatic access to Transpower land for the purposes of carrying out their own investments as proposed in clause (c)(ii). This amounts to expropriation of Transpower's property rights and is absolutely unacceptable to Transpower. Regardless of this fundamental point, the proposal would not achieve any financial benefits, as any work would be likely to be undertaken by the same contractors.

The Commission has not considered adequately the legal, operational and other implications of its proposal.

It is completely unacceptable to Transpower for counterparties or third parties to be entitled, as of right, to locate their investments on Transpower land. The Commission's proposal raises even more serious concerns than the operational and safety concerns raised by public access onto Transpower's land, which Transpower does not allow. Further, the Access and Occupation Schedule was never intended to cover occupation and ongoing access rights of a significant nature and is inappropriate for that purpose.

Location of a counterparty's investment on Transpower land would involve the counterparty's contractors, subcontractors, etc. entering onto the land to carry out the investment. Ongoing access would also be required by the counterparty and third parties for operating and maintenance purposes. Transpower has already pointed out to the Commission that its substations are not public areas and do not have public access. This is for both safety and operational reasons. However, the Commission's proposal would create additional difficulties. Not only would there be health and safety issues, there would be significant operational interface issues, as each party sought to manage the efficient operation of its own plant and equipment. Transpower would be exposed to a proliferation of works on its land, over which it had no or limited control. There would also be a lack of clarity over the responsibilities (and liabilities) each party assumed, which would be likely to lead to disputes.

The Commission does not appear to have considered the potential restrictions on Transpower's use of its own sites. Transpower might need to carry out its own investments on its sites, or might have other plans for any spare land on the sites it owns. While Transpower is prepared to allow essential investments to be located on its sites (and the current Access and Occupation Schedule allows for this), the investments the Commission proposes to be located on Transpower owned sites are likely, for the most part, to be of a discretionary nature, and could equally be located on non-Transpower land.

The Commission's proposal takes no account of the Resource Management Act implications for Transpower. Designations, resource consents and plan provisions are held in favour of Transpower for the specific activities carried out on its land. Compliance by Transpower with its existing consents and conditions may be put at risk by a counterparty/third party's investment, as it potentially increases the noise, vibration, EMF, EPR and other effects occurring on Transpower's sites. Creation of those effects by another party on the same site will also constrain Transpower's ability to create increased noise, traffic movements, site coverage, visual effects etc. that may be needed for its own upgrades or new activities. As a landowner, Transpower is also subject to potential liabilities under the Resource Management Act to manage and remedy any environmental effects emanating from its land, including from contamination or other discharges, whether or not they were caused by another party.

In short, Transpower strongly objects to the Commission's proposal. If a counterparty wishes to locate an investment on Transpower-owned land, that should be a matter for negotiation between the relevant parties and, if acceptable, commercial agreement. Transpower notes, in this respect, the Commission's proposal does not refer to consideration for the use of and access to the land.

Proposal that connected customers be permitted to specify their own VoLL for the purpose of evaluating possible investment in connection assets

At paragraph 27, the Commission has also sought views on whether or not customers should be given the opportunity to specify their own Value of Lost Load (VoLL) for use in applying the Grid Reliability Standards to connection assets. This could be achieved by providing in the Benchmark Agreement and in rule 5 of section II that, for the purposes of connection assets, the value of unserved energy (i.e. the VoLL) would be determined by the counterparties. The VoLL to be applied under the Grid Reliability Standards when calculating reliability benefits of an economic reliability investment would recognise the specific situation of the end-use customers served by those connection assets.

This value would be determined by the counterparty, acting reasonably, under the Benchmark Agreement and reviewed by the Commission under rule 5 of section II.

Transpower Response

Transpower disagrees with this proposal in relation to distribution companies, and generators and direct connects that share assets with other connected parties, for the same reasons as those described above in relation to the argument that the reliability of connection assets is a matter best left to bilateral negotiations between Transpower and counterparties, i.e. the principal-agent problem. Where the connected party is a distribution company, the VoLL estimated by the connected

party may not fairly reflect the mean VoLL of the distribution company's customers. This argument would apply, possibly more strongly, where distribution companies share connection assets and would also apply where the counterparty is a generator or direct connect that shares connection assets with other parties. Another contentious question which would need to be resolved is whether the VoLL figure to be applied should be the mean VoLL or the highest VoLL of any party connected at a particular grid connection point or any customer of such a connected party.

The concept of connected customers specifying their own VoLL values for the evaluation of investments in connection assets may be acceptable where the customer is an offtake or injection customer that is directly connected to the grid, does not share connection assets with any other party and has no offtake customers of its own. Any such arrangement would need to be approved by the Commission pursuant to rule 5.2 of section II of Part F of the Electricity Governance Rules.

3.6 Credit issues

The Commission has proposed that transmission customers with a long-term credit rating equal to or better than BB (or equivalent) on the Standard and Poor's rating scale should be entitled to have credit extended to them by Transpower without credit support, and that where credit support is required, it should be equivalent to two months' revenue from the customer.

Transpower does not agree that a BB credit rating provides sufficient security to warrant the extension of credit without credit support and has indicated that it would be prepared to accept a BBB credit rating as a rating "floor", as a compromise, although its preferred position is to retain the current A- rating threshold.

Standard and Poor's notes that obligations rated BB "are regarded as having significant speculative characteristics". The increase in Transpower's risk exposure created by the BB minimum credit rating would increase the operating capital that Transpower would need to provide in order to sustain core transmission services and cover operating risks. The consequent additional costs would be borne by connected customers as a whole, rather than the customers actually causing the additional risk. This is inequitable and inefficient.

For those customers required to provide credit support, the provision of two months' revenue as support (as proposed by the Commission) provides inadequate security in Transpower's view. It does not fairly reflect the likely length of time during which revenue might be lost or incorporate any allowance for the risk of stranded assets if a directly connected customer were to default. Consequently, Transpower would prefer to retain credit support of three months' revenue, as required by its existing Connection Contract.

Other submissions

Some submitters expressed support for the Commission's proposal to reduce the credit rating threshold above which credit support is not required

One submitter commented that the Commission's proposal struck the "right balance" between the cost of credit support and Transpower's risks

Transpower Response

Transpower disagrees with these views for the reasons described above, in particular, that it is inequitable and inefficient for all connected customers to share the additional cost caused by the default risk associated with customers whose credit ratings are at a speculative level.

Transpower should be subject to reciprocal credit requirements

Transpower Response

Given that Transpower's obligations under the Benchmark Agreement are to provide services, and not to make payment, reciprocity in the credit arrangements is unnecessary.

Credit rating minimum should be BBB (Powerco)

A credit rating of A- or some combination of letter of credit, bond and cash deposit should be required. (Orion provided an independent PWC report in support of this view.) Transpower should not have a role in assessing credit ratings. (Orion)

Transpower should not extend credit without credit support. To do so could affect Transpower's own credit rating, with the consequent costs flowing on to other customers. (Unison)

Transpower Response

Transpower agrees with these submitters' advocacy of a higher threshold credit rating for the extension of credit without credit support.

3.7 Balance of interests between Transpower and connected parties

A number of submitters have observed that the Commission has based the Benchmark Agreement on Transpower's existing connection contracts, and have objected to this approach, because they consider the Connection Contract to contain provisions which are unreasonably biased in Transpower's favour.

Transpower disagrees with this view. The Benchmark Agreement is the mechanism by which each party to the Agreement manages its risk. Efficient risk allocation means that risk should be allocated to the party best able to manage it. This must be construed according to the industry to which it relates (electricity transmission), the type of transaction

(provision of connection services), the parties to the transaction and the pricing structure of the contract, and must take into account the regulatory framework. Rule 4.2 of section II of Part F contains the principles for the Benchmark Agreement; also relevant are the Electricity Act 1992, the Government Policy Statement on Electricity Governance, October 2004 and Part 4A of the Commerce Act 1986. The predominant principles from the regulatory framework are efficiency and the least cost regulation of transmission services. Accordingly, it is not relevant to assess the Benchmark Agreement against a standard commercial contract, as the assessment and allocation of risks are driven by the regulatory framework.

Transpower's Connection Contract has been developed on the above basis; if more risk were to be allocated to Transpower, this would increase Transpower's economic costs and its revenue requirement. All customers would then be required to pay increased charges, regardless of whether or not they individually benefited from the reallocation of risk.