



**Submission to the Commerce Commission  
on its Draft Decisions and Reasons for Not  
Declaring Control & Draft Decision on  
Resetting Transpower's Thresholds:  
October 2007**

From

**Contact Energy Limited**

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## **Introduction**

Contact Energy welcomes the opportunity to provide feedback to the Commerce Commission on its Draft Decisions. Contact's response follows over the page.

For any questions related to this submission, please contact:

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Contact is mindful of the need for Transpower to maintain a reliable electricity transmission grid and is supportive of the intent of the Commerce Commission's Draft Decisions. However, Contact would like to highlight what it sees as some anomalies in the Draft Decisions where the intent of the Purpose set out in Section 57E of Part 4A of the Commerce Act, to promote the efficient operation of markets directly related to electricity distribution and transmission, is not fully served.

### **Transparency of EV accounts**

In general, Contact is of the view that greater transparency around all of Transpower's processes will help to ensure that it continues to improve efficiency and carries on providing a quality of service that reflects consumer demands, as per Section 57E(b).

In particular, paragraphs E20 – E23 of the Commission's Draft Decisions Report notes that Transpower's settlement proposal causes price increases (10.2% for 2006/07 and 8.2% for 2007/08) and that the gains arising from the price increases will be applied against the Economic Value ("EV") Customer Accounts. Contact considers that the Commission could better serve the intent of Section 57E by ensuring greater transparency in how the EV Accounts (for HVAC & HVDC separately) will be changed by the price increases.

In addition, Contact seeks transparency on how this relates to the price increase that Transpower applied for the 2007/08 pricing year (which increased prices by an average of 15.2% from 2005/06 levels). Contact requests that Transpower be required to publish detailed, disaggregated accounts, showing how the price increases for each pricing year will impact on both HVAC and HVDC assets. Furthermore, Contact requests that Transpower be required to publish EV accounts for both HVAC & HVDC assets as part of its annual compliance report. Such information would include:

- Opening balances,

- EV recoveries and/or rebates from customers,
- any changes in EV from asset revaluations, and/or over/under recovery of revenue, independently identified and explained
- interest charged; and
- Closing balance.

Also related to transparency around Transpower's processes, currently Transpower gives formal notice in December, of prices that take effect in April of the following year. Due to the step changes in pricing that will happen as a result of the settlement with Transpower, Contact would like to see a longer notification period, with for example, formal notification in December, of prices that take effect in April of the following year, but also with indicative notification of prices for the next three years after that. Contact considers that having longer notification periods for pricing will give greater certainty for business planning and enhance the efficient operation of the market.

### **HVDC Assets and Electricity Commission's Transmission Pricing Methodology**

Contact acknowledges that the transmission pricing methodology is approved by the Electricity Commission and has no bearing on the application of the price path set by the Commerce Commission or Transpower's proposed settlement. However, Contact believes that there are potentially major issues in how the transmission pricing methodology and the price path interact and this may impact on the efficient operation of markets related to electricity distribution and transmission. It is Contact's view that further clarity is required around the interrelationship. By way of example, Contact proposes that a greater level of transparency is required with respect to the price path determination around assets, by type (HVAC & HVDC), and how this is translated into Transmission charges.

If there is no transparency then Transpower's settlement is likely to continue to increase disproportionately the charges paid by South Island electricity

generators for HVDC assets when compared to the increases they face for HVAC assets. Such a disparity may have a negative impact on the efficient operation of the market. Contact suggests that the Commission review this possibility further. Such a review may require co-ordination between the Commerce and Electricity Commissions, but Contact believes it would be of value to all parties.

### **Transpower's Valuation of Assets Based On The Revised 2006 ODV Building Blocks**

Contact acknowledges that Transpower requires a starting point ("base case") from which to change its revenue requirement process from an ODV to a DHC basis. However, Contact would point out that there are some anomalies associated with the 2006 Valuation of assets.

Transpower have noted that the 2006 Valuation is a representation of the necessary assets to provide the level of service required from the National Grid. As a consequence, assets may be optimised in or out, dependent on Transpower's analysis. It is Contact's understanding, that as part of this valuation, there are "imaginary" assets<sup>1</sup> which get optimised in under the ODV methodology. In changing to a DHC methodology, and setting the base case to the 2006 Valuation, these "imaginary" assets get included into the revenue requirement and are depreciated over time alongside the physical assets included in the valuation. Contact questions the appropriateness of Transpower being able to recover revenue from assets that do not physically exist.

In addition, the 2006 Valuation "values" the HVDC assets on the basis that a capability equivalent to 1000 MW is provided. However, it is not clear how such a valuation deals with a reduction in capability, such as the recent removal from service of Pole 1. If Pole 1 is not returned to service, then under the 2006 Valuation, Transpower will be recovering revenue on assets which

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<sup>1</sup> For example, Benmore interconnecting transformer T999

will not be in service, and not providing the level of service to which they are valued. It is Contact's view that this is inappropriate. Contact requests that the Commission investigate the use of the 2006 Valuation for the HVDC further – is Transpower being provided with strong incentives to improve efficiency and provide services at a quality that reflects consumers demands, as per Section 57E(b), when it is permitted to recover revenue from out-of-service assets?

### **Use of Pseudo Assets**

Transpower has proposed the concept of Pseudo Assets to account for the difference between its transmission system fixed asset ODV register and its financial reporting fixed register. While Contact understands the usefulness of this for transitioning to a single register, it questions the validity of the use of Pseudo Assets and their "rapid depreciation".

It is Contact's understanding that the "rapid depreciation" over 4-10 years of the four classes of Pseudo Assets, is intended to be no different in Present Value terms, than depreciating the assets over their remaining life under the ODV methodology. Contact requests that the Commission clarifies how this applies for HVDC assets and specifically the 40+ year old Pole 1 HVDC assets.

The expected life of Pole 1 was 30 years. Over the last decade the remaining life of Pole 1 has (annually) been extended by three years in accordance with the ODV methodology. While Pole 2 does still have a remaining life (~13 years) Contact questions the appropriateness of including the Pole 1 assets in the HVDC Pseudo Asset calculation, especially as Transpower has had the depreciation benefit from Pole 1 for the last decade, despite the asset's life expectancy expiring.

The inappropriateness of Pole 1 being included in the "Pseudo Asset approach" is compounded when considering Pole 1's removal from service in September 2007. If Pole 1 is not returned, Transpower will again be

recovering revenue (including accelerated depreciation and/or write off) for an asset which has exceeded its life expectancy and is not even providing a service. Again, Contact suggests that the intent of the Commission's Purpose, especially 57E(b), is not being fully served by this.

Contact requests that Transpower be required to remove Pole 1 assets from the Pseudo Asset calculation and from the 2006 Valuation, and apply any perceived "write off" to its shareholder account, not the customer EV account.

### **Lack of Service Level Criteria and Other Anomalies in Transpower's Proposed Settlement**

Contact would like to note, that under the proposed Administrative Settlement, there is no linkage to service. It is Contact's understanding that the proposed DHC Valuation only applies to the assets, and is not impacted whether or not those assets are in service. Taking this theory to the extreme, Transpower could determine its revenue requirement on the national grid based on the assets, and remove them all from service, but still be able to recover its revenue. While this seems ludicrous, there is nothing which prevents Transpower from restricting or removing a level of service, and there is no financial consequence for them doing so.

Contact proposes that the Commission review this anomaly, and include a requirement on Transpower to "recalculate" its Revenue Requirement, should it change the level of service of its assets, either through de-rating (a reduction in capacity / availability) them or by their extended removal from service. Further, Contact requests that any such recalculation result in a corresponding adjustment to the revenue that Transpower will receive, and be reflected in a corresponding adjustment to charges to customers. It is Contact's view that not holding Transpower accountable for the service levels associated with the assets for which it receives income, hinders the efficient operation of the market and goes against Section 57E(b) because it does not provide a strong incentive for Transpower to provide services at a quality that reflects consumer demands.

## **WACC**

It is Contact's view that under the proposed Administrative Settlement, Transpower faces very low revenue risk in comparison to other similar businesses. This is demonstrated by the fact that Transpower can remove assets from service and suffer no loss of revenue. On this basis, Contact suggests that Transpower's level of risk is overstated.

## **Conclusion**

Contact reiterates that it is mindful of the need for Transpower to maintain an efficient electricity transmission network and is generally supportive of the Commission's Draft Decisions. As noted however, there maybe some anomalies in the Decisions which do not fully serve the Section 57E Purpose from the Commerce Act.

Going forward, Contact notes that the proposed administrative settlement applies from 01 July 2007 to 30 June 2011. Contact seeks clarity on what is likely to be applied at the expiry of this settlement, or at least the process that the Commission is likely to follow at that time.

Contact, as with other market participants, has a preference for certainty around Transpower's revenue (and hence transmission charging), especially when considering investment in long-life generation assets.