



MAJOR ELECTRICITY USERS' GROUP

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Mr Callum Gunn
Chief Advisor, Network Performance
Commerce Commission

By email to electricity@comcom.govt.nz

Dear Callum

Submission on Revised Draft ODV Handbook (9 July 2004)

The table below lists suggested changes to the Revised Draft Optimised Deprival Valuation (ODV) Handbook released 9 July 2004. The right hand column of the table explains why the changes are proposed.

Inserted text bold red and underlined, deleted text red strikethrough	Comments
Paragraph 1.8, p7: <i>This handbook does not require a comprehensive EV test to be applied where an ELB is satisfied that the application of such a test will not lead to an ODV valuation that is materially lower than the ODRC valuation. <u>Sufficient information shall be disclosed in the ODV report to allow third parties to independently assess the materiality of possible EV situations.</u></i>	Leaving EV tests to the discretion of ELB is problematic. MEUG suggest ODV reports provide sufficient information to allow interested parties to make their own assessment where ELB fail to do so.
1 st sentence, paragraph 2.6, p8: <i>Only system fixed assets owned by the ELB or subject to a finance lease <u>(or operating leases that are in effect financing arrangements)</u> are to be included in the reported ODV valuation</i>	Operating leases are in effect financing arrangements related to assets held off balance sheet. The asset and debt equivalents should be made explicit.
1 st sentence, paragraph 2.7, p9: <i>The following <u>tangible</u> assets shall not be included in the ODV valuation</i>	To ensure there is no uncertainty that the list of items in this paragraph only cover tangible assets, and not intangibles, suggest adding "tangible" in the text.
Last sentence, paragraph 2.18, p11: <i>A general description of the methodology used to optimise the network must be included in the valuation report <u>and an explanation of changes in optimisation compared to the prior ODV.</u></i>	Optimisations are not new and after so many years of ODV it should be rare to have significant changes in optimisation. Nevertheless ELB have incentives to change optimisation approaches to maximise value. To guard against this risk MEUG suggest ELB must explain all changes in optimisation quantities and values compared to those in prior ODV.
Last sentence, paragraph 2.19, p11: <i>The most cost efficient design is the one that minimises the present value of the total costs of the assets and their use over their standard life. In undertaking life cycle cost analyses to determine the most efficient design an ELB may take into account: (i) the capital and</i>	The factors listed in paragraph 2.19 are very important and should be disclosed to allow third parties to review them.

<p>operating costs over the life of the asset; (ii) other costs that are incurred by the ELB as a result of the use of the asset¹; and (iii) the cost of losses to the extent that these are caused by the existing load and the allowed future load growth. <u>All of these assumptions must be disclosed in the ODV report.</u></p>	
<p>Paragraph 2.27, p13: <i>In order to ensure compliance with clause 2.26, ELBs must disclose, in the valuation report, both existing loads and the load forecast <u>(annual kWh and peak MW)</u> used as a basis for optimisation. As a minimum, existing and forecast loads must be provided for each <u>Grid Exit</u> point of connection, each zone substation and each high voltage distribution feeder. Clear justification and a detailed derivation of the load growth forecasts are required. <u>As part of estimating load growth ELBs must consult with retailers trading over their network and appropriate representatives of end users' or in the case of very large users' (eg > 1% load) shall consult them directly. Load forecast shall be consistent with Asset Management Plans and where differences arise ELB shall provide a detailed explanation.</u> Both the existing maximum demand and the highest forecast maximum demand during the planning period must be provided. Allowances should be made, where possible, for different growth rates in different parts of the network. Existing loads may be estimated where metering is not available.</i></p>	<p>Load forecasts are a key assumption when calculating ODV. To ensure the quality of load forecasts is robust, MEUG suggest ELB should consult retailers and large end users'.</p> <p>The suggested inclusion of energy (kWh) and peak capacity (MW) is for clarity.</p> <p>Similarly the prefix "Grid Exit" to the phrase "point of connection" is to ensure the latter is not confused with points of connection by end consumers (ICP).</p>
<p>Last 2 sentences, paragraph 2.35, p15: <i>Furthermore, the quality of supply criteria should be in accordance with relevant decisions of the Electricity Commission and the contractual relationship between Transpower and its connected customers. For the avoidance of doubt, optimisation of transmission projects that have been approved by the Electricity Commission is not required</i></p>	<p>Until the Electricity Commission decides transmission terms and conditions (including pricing) through the Part F process of the Electricity Governance Rules 2003, it is premature to state categorically how optimisation will be treated for Transpower. Therefore the last sentence should be deleted.</p>
<p>Paragraph 2.55, p18: <i>Assets whose remaining life is less than three years <u>one year</u> shall be deemed to have a residual life of three years <u>an ODRC of \$1,000 and the quantities and values of those assets shall be clearly identified in the ODV report.</u></i></p>	<p>The proposed 3-year minimum residual life will allow ELB to earn, in NPV terms, more than the RC of the asset. ELBs should only receive a return on capital once.</p> <p>If the rationale for having 3 years is because a book value of some sort is needed, then MEUG suggest:</p> <ol style="list-style-type: none"> 1. A value of \$1,000 should suffice (and be material enough that auditors will be satisfied); and 2. Rather than 3 years, the smallest number of years should be used, ie 1 year. <p>To allow third parties to monitor the quantity and value of assets that are included in the ODV that have exceeded their life, MEUG recommend that details be disclosed in the ODV report.</p>
<p>Paragraph 2.60.4, p19: <i>The EV of the potentially uneconomic system fixed assets is the present value of the total costs of providing the alternative service less the present value of the total operating and maintenance costs of the existing network assets, discounted at the ELB's WACC and depreciated to reflect the weighted-average remaining life of the existing network assets. This can be expressed <u>as by comparing alternatives against the ELB assets over the life cycle of the ELB assets as given in the following formula or by comparing the remaining costs of the ELB asset over its remaining life with alternatives calculated using a lifecycle that finishes at the same time as the existing ELB asset.</u></i></p>	<p>The formula requires alternatives to be calculated over the whole ELB asset life cycle. There are problems with this, eg if a spur is 50 years old and 10 years remaining life then the alternative to supply just 10 years may be a new technology that wasn't available 50 years ago and therefore you cannot compare using a full life cycle analysis. Therefore MEUG suggest allowing EV to be calculated just on the remaining lifecycle but ensuring they are truly like with like.</p>

¹ An example of such costs is transmission connection charges incurred by a distribution ELB.

<p>Paragraph 2.61, p19:</p> <p><i>Where an ELB does not undertake a comprehensive EV test on any of its network assets in accordance with the provisions of clause 2.59, it shall include in its valuation report a signed statement stating that: (i) it has reviewed its system fixed asset base and sought to identify assets that may potentially be uneconomic; and (ii) it is satisfied that an EV analysis of these assets would not result in an ODV of its system fixed assets that is materially less than the ODRC of its system fixed assets. The valuation report should further describe the basis upon which this conclusion was formed <u>and sufficient information shall be disclosed in the ODV report to allow third parties to independently assess the materiality of possible EV situations</u></i></p>	<p>Leaving EV tests to the discretion of ELB is problematic. MEUG suggest ODV reports provide sufficient information to allow interested parties to make their own assessment where ELB fail to do so.</p> <p>This change is consistent with the proposed change to paragraph 1.8 noted beforehand.</p>
<p>Paragraph 2.62, p19:</p> <p><i>Where an ELB conducts a comprehensive EV test to analyse its potentially uneconomic assets in accordance with clause 2.59, the valuation report shall include: (i) a description of the methodology used to identify the potentially economic assets to which an EV test was applied; (ii) a description of the EV test methodology; and (iii) the ODRC and calculated EV of the assets tested. Detailed EV calculations <u>must need not</u> be included.</i></p>	<p>Detailed calculations should be included to allow independent assessment by third parties of the ELB assessment. Most ELB already provide detailed calculations – it would be a backward step to discontinue this important information being public.</p>
<p>Paragraph 2.62, subparagraph 2, p20:</p> <p><i>The RC, ORC, DRC, and ODRC for each asset class and for the valuation asset base <u>grouped by each Grid Exit point of connection, each zone substation and each high voltage distribution feeder and</u> as a whole. This information should be shown separately for stores and spares, which need not be disaggregated into asset classes</i></p>	<p>Asset quantities and values need to be sufficiently disaggregated and grouped to allow analysis by third parties of information such as:</p> <ul style="list-style-type: none"> • Separate regional asset bases - having asset information grouped by Grid Exit Point of Connection is necessary for this. If the ODV reports do not specify this then ELB with assets in unconnected regions will be able to simply provide an aggregate of quantity and value for each asset class and third parties will not be able to assess any possible cross-subsidisation in prices to recover asset costs between regions; • Through to allowing assessment of possible EV situations - asset and load growth information to the high voltage distribution feeder level is needed for this. <p>ELB are required (paragraph 2.27) to undertake load forecast at a minimum by Grid Exit Point of Connection, zone substation and high voltage distribution feeders – therefore they must already have asset information available in these groupings, so providing it in the ODV handbook should incur no additional cost.</p>
<p>Paragraph 2.64, p20:</p> <p><i>It is important to the integrity of the Commission's Requirements under subpart 3 of Part 4A of the Act that valuations be transparent <u>and useable</u>. ELBs are therefore required to provide an ODV valuation report <u>including a summary report using a standard template to be advised by the Commission</u>. As a general principle, sufficient information should be included in a valuation report to allow stakeholders to independently assess the validity and robustness of the reported ODV valuation of the system fixed assets.</i></p>	<p>The quality of ODV reports to date has been highly variable. As a result third parties have had difficulty comparing the ODV of any one ELB with that of others. The ODV Handbook should improve the usability of ODV by requiring ELB to publish key summary information in a standard template.</p>
<p>Paragraph 2.65, subparagraph 9, p21:</p> <p><i>The existing loads and the load growth forecast used as a basis for optimisation. This information should be disaggregated by point of connection, zone substation and high voltage distribution feeder, <u>an explanation of changes in optimisation compared to the prior</u></i></p>	<p>Optimisations are not new and after so many years of ODV it should be rare to have significant changes in optimisation. Nevertheless ELB have incentives to change optimisation approaches to</p>

<p><u>ODV and details of all assumptions used in the life cycle analysis of the assets (ie(i) the capital and operating costs over the life of the asset; (ii) other costs that are incurred by the ELB as a result of the use of the asset²; and (iii) the cost of losses to the extent that these are caused by the existing load and the allowed future load growth</u> . (clause 2.27 <u>and clause 2.19</u>);</p>	<p>maximise value. To guard against this risk MEUG suggest ELB must explain all changes in optimisation quantities and values compared to those in prior ODV.</p> <p>This change is consistent with the proposed change to paragraphs 2.18 and 2.19 noted beforehand.</p>
<p>Paragraph 2.65, subparagraph 17, p21: <i>Where an ELB does not undertake a comprehensive EV test on any of its system fixed assets in accordance with the provisions of clause 2.59, a signed statement stating that (i) it has reviewed its system fixed asset base and identified assets that are potentially uneconomic, and (ii) it is satisfied that an economic valuation of these assets would not result in a material reduction of the ODV of its system fixed assets and a description of the basis on which this conclusion was formed (clause 2.61). <u>The ELB must disclose sufficient information in the ODV report to allow third parties to independently assess the materiality of possible EV situations</u>; or</i></p>	<p>Leaving EV tests to the discretion of ELB is problematic. MEUG suggest ODV reports provide sufficient information to allow interested parties to make their own assessment where ELB fail to do so.</p> <p>This change is consistent with the proposed change to paragraph 1.8 and paragraph 2.61 noted beforehand.</p>
<p>Paragraph 2.65, subparagraph 18, p21: <i>Where a comprehensive EV test is undertaken as part of the valuation process, (i) a description of the methodology used to identify the potentially economic system fixed assets to which the comprehensive EV test was applied, (ii) a description of the EV test methodology, and (iii) the ODRC and calculated EV of the assets tested. <u>Detailed EV calculations must be included</u> (clause 2.62).</i></p>	<p>Detailed calculations should be included to allow independent assessment by third parties of the ELB assessment. Most ELB already provide detailed calculations – it would be a backward step to discontinue this important information being public.</p> <p>This change is consistent with the proposed change to paragraph 2.62 noted beforehand.</p>
<p>Last paragraph, B.7, p55: <i>Optimise the trenching arrangement of existing underground cables <u>and nearby underground utilities where co-joint trenching is possible</u>. Cables/<u>other utility</u> running close together, or on the same side of any road or street must be optimised to a single trench except where this would not meet the ELB's disclosed quality of supply criteria. Derating factors applicable to cables run in a single trench should be considered when making this assessment. If more than one underground cable/<u>other utility</u> is laid in a trench, only the incremental cost of the additional cable(s) <u>/other utility</u> may be included in the valuation. Table A1 provides standard costs for double circuit cables.</i></p>	<p>Where cables can be co-located in a trench with other utilities at lower cost than in separate trenches, then ELB should do so. The ODV Handbook should recognise this possibility</p>
<p>Last paragraph, B.9, p57: Adopt similar changes as last paragraph. B.7, p55 noted above</p>	<p>Same explanation as proposal for last paragraph. B.7, p55 noted above</p>
<p>Last paragraph, B.12, p59: Adopt similar changes as last paragraph. B.7, p55 noted above</p>	<p>Same explanation as proposal for last paragraph. B.7, p55 noted above</p>

Please call me on 494 0996 if further explanation is needed.

Yours sincerely



Ralph Matthes
Executive Director

² An example of such costs is transmission connection charges incurred by a distribution ELB.