



Submission to
Commerce Commission on
Revised Draft of the
ODV Handbook

30 July 2004

CONTENTS

1	EXECUTIVE SUMMARY	1
2	INTRODUCTION.....	3
3	SUPPORTED CHANGES SINCE LAST VERSION OF THE HANDBOOK.....	4
4	PROCESS	4
5	PRINCIPLE-BASED APPROACH TO VALUATION	5
6	SCOPE OF THE ODV HANDBOOK	6
7	ARE 'STANDARD COSTS' SIMPLY 'MAXIMUM COSTS'?	6
8	EV TESTING.....	7
9	MULTIPLIERS	8
10	OPTIMISATION	8
11	ASSET COSTS	9
12	ASSET LIVES	10
13	EXCLUDED ASSETS	11
14	REPORTING REQUIREMENTS.....	11
15	UNADDRESSED ISSUES	11
16	TRANSPower AND OPTIMISATION	15

1 EXECUTIVE SUMMARY

- 1.1 Vector appreciates the opportunity to provide input to the Commerce Commission's revised draft ODV Handbook. Vector appreciates the Commission further consulting on the Handbook.
- 1.2 Notwithstanding this further consultation, however, Vector continues to have concerns regarding the process for updating the handbook, routed in the fragmented approach to elaborating all relevant valuation matters. For example, it is not yet clear whether the Electricity Commission has been engaged (e.g. with respect to interface issues with Part F); nor whether the development of standard costs has drawn on external evidence. Further, the Commission has still not made final decisions on asset valuation; nor described an over-arching approach to valuation that includes other valuation components besides the ODV Handbook.
- 1.3 While the revised draft of the handbook better addresses a range of valuation matters (e.g. traffic management, widening of multiplier values), there remain some important areas for further improvement, viz:
 - o the adoption of a principle-based approach. Vector has previously submitted to the Commission that the valuation handbook, and valuation outcomes, would be better-served through the adoption of an over-arching principle in the handbook that actual costs could be used where demonstrated that they are an efficient level of costs. The Commission has not commented to date on this approach and, if the Commission does not support it, explained why;
 - o elaboration of a process for updating the handbook over time; while the Commission has said this process will be elaborated in future, in Vector's view it should have been an intrinsic part of the handbook update itself;
 - o a range of other important submissions by Vector and other parties need to be addressed or discussed by the Commission (e.g. planning periods; exclusion of street lighting, mobile generators and substations; the requirement to optimise cables in the same side of the street to single trench). While appreciative of the extent of the task of considering submissions, Vector is concerned that legitimate issues raised by submitters appear to have been ignored;
 - o a range of low-value items in the handbook (e.g. non-standard costs, optimisations, application of multipliers) require an excessive level of reporting, which must be streamlined or subject to a materiality threshold before such reporting is required;
 - o Transpower's exclusion on the application of optimisation of its assets where projects have been approved by the Electricity Commission must be abandoned. An exclusion is unjustified and singles out Transpower for

differentiated, more favourable treatment than for other lines businesses (who may also invest in transmission alternatives (e.g. through distribution network augmentation)) without protection from optimisation (nor, in some cases, with those investments allowable under the ODV Handbook). The approach will also have the flow on effect of increasing the transmission charges faced by consumers as Transpower will determine its allowable revenue based on a non-optimised grid even where assets are bypassed or under utilised. This underscores the importance of the Commission consulting with the Electricity Commission on the handbook and, more generally, considering cross-cutting or interface issues between the Commissions.

- 1.4 Vector is also a party to a submission made by the Electricity Networks Association (ENA). Vector, having been part of the process culminating in that submission, endorses the views put forward by ENA.

2 Introduction

2.1 This submission from Vector Ltd (Vector) is in response to the following publications from the Commerce Commission ("the Commission"):

- (a) a short paper by the Commission inviting submissions (9 July 2004), which discusses some valuation issues ("the Commission's paper");
- (b) a supporting paper from the Commission's expert advisor, Parsons Brinckerhoff, providing further detail, including supporting analysis and assumptions, for the valuation Handbook ("the PB report");
- (c) the revised draft of the ODV Handbook ("the revised Handbook").

2.2 Vector appreciates the opportunity to comment on these papers and would be happy to elaborate on any views if useful to you.

2.3 Vector's general comments are discussed below under the following headings:

- o Supported changes since last version of the handbook;
- o Process;
- o Principle-based approach to valuation;
- o Scope of the ODV Handbook;
- o Are 'standard costs' simply 'maximum costs'?
- o EV testing;
- o Multipliers;
- o Optimisation;
- o Asset costs;
- o Asset lives;
- o Reporting requirements;
- o Unaddressed issues; and
- o Transpower and optimisation.

2.4 Vector is also a party to a submission made by the Electricity Networks Association (ENA). Vector, having been part of the process culminating in that submission, endorses the views put forward by ENA.

3 Supported changes since last version of the handbook

- 3.1 Vector is supportive of a range of changes made in the latest version of the handbook, including:
- (a) clarification of Handbook introduction and a general increase in the level quality of narrative throughout the handbook;
 - (b) use of term “standard costs” versus “maximum costs” (although with some reservations as to the substance of the change);
 - (c) adjustment of traffic management costs to more realistic levels;
 - (d) widening of multiplier values to capture the additional costs faced in high density urban centres;
 - (e) removal of some of the limited value and high effort optimisation requirements; and
 - (f) clarification of fixed asset recording requirements.
- 3.2 Given Vector’s support for the currently proposed treatment of these issues, they are generally not discussed in this submission, other than to the extent that they are relevant to other matters.

4 Process

- 4.1 As noted above, Vector appreciates the Commission further consulting on the handbook.
- 4.2 Vector continues, however, to have concerns regarding the process for updating the handbook, routed in the fragmented approach to elaborating all relevant valuation matters. For example, Vector has the following concerns:
- (a) the Commission has not made final decisions on the role of asset valuation generally and the method(s) that could be used. The Commission has made only *draft* decisions. While not optimal, the Commission could theoretically decide that ODV could not be used by lines businesses in the regulatory regime;
 - (b) the Commission’s process seems to having a continued focus on tinkering with the handbook without properly addressing bigger picture considerations, such as the context for the use of the Handbook and valuation principles (including valuation of non system fixed assets); and

- (c) it is not clear (but Vector suspects not) whether the Electricity Commission has been properly engaged to ensure the Handbook properly accommodates a range of issues that the Commission will work on (for example, the PB Report notes the inherent problems for asset valuation associated with distributed generation); and
- (d) insufficient level of rigour and background support to the task of updating the standard asset costs. It is not clear whether the development of standard costs has drawn on external, market evidence; a fundamental component of the Commission's consultant verifying costs proposed by submitters.¹

4.3 In the Commission's paper, the Commission appears to try and address such process concerns as pointing to other work underway or committed to in the future. However, this is very different in Vector's view to a proper sequencing of work, which would have seen the above issues addressed alongside the updating of the handbook so that all relevant valuation matters could be considered contemporaneously.

4.4 One of the Commission's pieces of promised work is a 'companion document' to the handbook at the time it is finalised. However, given that many of the issues covered in that document may be relevant to the ODV method and its applications, Vector's view is that the companion document should have been issued alongside the latest version of the handbook for comment on by interested parties.

5 Principle-based approach to valuation

5.1 Vector has previously submitted to the Commission that the valuation handbook, and valuation outcomes, would be better-served through adoption of an over-arching principle in the handbook that actual costs could be used where demonstrated that they are an efficient level of costs. In Vector's view, principles are better suited to dealing with a range of complex issues that may arise over time. Principles can also readily ensure a true and fair valuation, so long as their application is scrutinised by an independent, auditing party.

5.2 In its last submission, Vector submitted a suggested principle (appropriately drafted) that could be inserted into the handbook to this effect.

5.3 Vector remains of the view that accurate valuations will only result, including over time (given the inherent durability of a principle-based approach), if an

¹ An example of PB's lack of rigour is the unjustified manipulation of submitted costs in its discussion of overhead distribution lines. PB states in paragraph 3.3 that they have discounted the costs submitted by PWC by 5%, but do not provide sufficient justification as to why this figure was chosen or how this compared to its external determination of costs (if any were done). Vector considers a more robust approach is required.

actual cost principle (along the lines suggested by Vector in its last submission) is adopted. If the Commission has concerns with the wholesale adoption of that principle, then it should explain why. If not accepted in entirety, the Commission should also consider whether such a principle could be applied subject to some materiality threshold, i.e. where it can be demonstrated actual costs are greater than the standard costs by some specified percentage.

- 5.4 A range of other important submissions by Vector and other parties were also not addressed or discussed by the Commission (e.g. planning periods; exclusion of street lighting, mobile generators and substations; the requirement to optimise cables in the same side of the street to single trench).
- 5.5 Vector is disappointed that the Commission has not discussed the above-mentioned issues in its latest materials, nor explained, for example why the principle-based approach advocated by Vector has not been adopted. This leaves interested parties, such as Vector, as not knowing whether the Commission disagrees with the submission made (and, if so, for what reasons) or simply has not turned its mind to it, or even considered it.
- 5.6 While appreciative of the extent of the task of considering submissions, Vector is concerned, particularly in the case of the principle-based approach, that such a fundamental submission would not be responded to in any way. Vector does not expect all matters raised in its submissions to be addressed; however, we do expect key concerns and suggestions to be acknowledged and, if not accepted, explained why.

6 Scope of the ODV Handbook

- 6.1 In the Commission's paper, the Commission explains that (para 25) *"[w]hile it is not typical for non-system fixed assets used to provide lines businesses services to be valued using the ODV methodology, these assets are normally included in the regulatory asset base."*
- 6.2 Vector requests that a comment to this effect be inserted into the ODV Handbook to place asset valuations within a broader context that appropriately allows other costs to be included in an overall asset base. While useful for this context, an addition as suggested by Vector would also help mitigate unhelpful inferences being drawn about rates of return based on examination of ODV valuations only.

7 Are 'standard costs' simply 'maximum costs'?

- 7.1 The Commission proposes the adoption of standard costs, which it suggests is different to the concept of maximum costs in the existing published version of

the handbook. Further (para 33), *“the Commission proposes that standard replacements costs in the new ODV handbook will apply to all system fixed assets (except fixed assets deemed to be “non-standard”), regardless of whether actual replacement costs are higher or lower than the standard values.”* And then if thresholds are breached, *“lines businesses could still provide evidence to support asset replacement costs materially different from the standard values in the handbook”* (para 34).

7.2 Vector supports the Commission’s change to the standard cost approach, but makes the following observations:

- for all intents and purposes, the standard costs are simply maximum costs given they cannot be exceeded, i.e. the change made by the Commission is in name only, not substance;
- the ‘one-cost-fits-all’ approach is not conducive to obtaining accurate valuations that reflect efficient costs;
- the approach will suffer from the same drawback over time as with maximum costs, i.e. they can become quickly outdated requiring further updates (a process yet to be clarified by the Commission);
- if providing evidence post a threshold breach is sufficient basis to use actual costs, why can this not be done through the valuation process itself?
- what does the Commission mean by ‘materially different’?

7.3 Vector recognises the pragmatism behind the Commission’s proposed approach, but considers that it has provided the Commission with an alternative, workable approach - a principle-based approach – that would result in more accurate valuations that reflect efficient costs, including over time. The Commission should explain why it does not consider this approach workable before relying on the distant second-best prescription proposed.

8 EV Testing

8.1 The revised handbook makes significant reversals for the application of the EV test. Whereas the previous draft did not require analysis of the network to be undertaken unless directed by the Commission, the current draft is less clear on the matter.

8.2 Previous arguments around relaxing the requirement to provide EV testing were premised on the fact that a substantial amount of resources were consumed meeting the testing requirements versus the minimal level of optimisation that resulted. As a result, the general requirement to conduct EV testing was abandoned in the last version of the draft handbook (although it still remained a

part of the valuation methodology, hence retaining the ODV methodology). This was generally accepted by most submitters as a positive step.

- 8.3 The new wording of the EV testing requirements is not clear as to how it would be met in practice. The current wording suggests a subjective test in order to determine if the 1% threshold will be met. However, valuation auditors may not take the same view and may require the preparation of detailed EV analysis in order to meet the test – thereby reverting to the previous handbook requirements. This would appear counter to the reasons originally underpinning removal of the blanket EV testing requirement.
- 8.4 It would be useful if the Commission elaborated on how it envisages this new EV requirement to be met in practice – in particular the level of supporting evidence to be supplied by lines businesses to indicate they fall under the proposed materiality threshold.
- 8.5 Vector remains of the view that the treatment of the EV test in the last version of the draft handbook was much preferable.

9 Multipliers

- 9.1 Vector welcomes the adjustment of the business district multiplier to recognise the increased reinstatement costs that are faced by lines businesses in urban areas.
- 9.2 Vector, however, considers that there is a gap in recognising that the higher-than-standard costs due to reinstatement may occur in non-business districts. Such examples include residential streets where services cannot be laid in the grass berm due to a range of reasons, including overcrowding of services, tree roots and lack of a grass berm.
- 9.3 While the costs of reinstatement may not approach the same levels as in the business districts, there is a need – for consistency, as well as accuracy – to account for these non standard costs, particularly given more services are being placed underground over time in line with council and customer requirements.
- 9.4 Vector supports the addition of a multiplier (or an extension of the scope of the business district multiplier) that will allow lines businesses who can identify areas of increased reinstatement costs to recognise this in the valuation.

10 Optimisation

Underground to Overhead

- 10.1 In the last version of the handbook, the requirement to provide evidence that underground cables should not be optimised to overhead lines was removed. Submitters provided significant evidence that undergrounding was in most areas mandated by local authorities or driven by reliability or safety issues, or customer requirements.
- 10.2 The revised handbook has reintroduced the requirement to provide evidence that overhead lines are sub-optimal, albeit a wider and more encompassing justification is allowed than was the case under the 4th Edition Handbook.
- 10.3 Vector questions the benefit of reintroducing this mandatory test on all cables owned by lines businesses, particularly given no discussion as to the factors leading the Commission to this view have been provided. It is generally accepted that local authorities are requiring lines businesses to place their conductors underground. A mandatory requirement to provide evidence of this seems to go contrary to the aim of streamlining the valuation process.

Future load growth

- 10.4 Vector is unclear as to the reasons behind the introduction of a requirement under 2.29 of the revised handbook to identify loads exceeding 5% of the lines business' maximum demand. The actual identification of planned loads seems onerous and of little value to the valuation process. Micro-level reporting on load forecasting and system planning is not a function of the valuation methodology and should not be included in the valuation process.
- 10.5 This additional disclosure requirement also raises issues around commercial sensitivity where parties are considering significant business investment that they may not wish to disclose to their competitors.

11 Asset costs

Non-Standard Costs

- 11.1 The draft handbook requires lines businesses to provide analysis of life cycle costs, service potential and significant scale in justifying MEA costs used for non-standard assets. This is potentially a large body of work for assets that generally make up a very small part of the valuation.

- 11.2 Vector suggests a materiality threshold be adopted, such as has been used for EV testing (e.g. if an asset class makes up 1% or greater of the ODRC valuation and is a non-standard or non-specified asset then sufficiently detailed analysis should be undertaken and provided in the report to justify the costs used).
- 11.3 This would allow significant items such as zone transformers to be reported on and assessed while allowing a less stringent test for low value items such as line fault indicators, capacitors and possum guards. For assets which fall below this threshold, replacement costs should be determined using the general valuation principles prescribed in the handbook of competitive pricing for a significantly sized project.

12 Asset lives

Distribution buildings

- 12.1 As previously submitted, Vector considers a 60-year life is more appropriate than the 50 years allowed by the revised handbook. This is in line with the standard lives used in recent independent FRS-3 valuations of its buildings.
- 12.2 Vector also considers the discrepancy between the allowable lives for transmission buildings to be unjustified – 55 years versus 50 years. Vector has over 40 buildings that are older than 50 years and still in good condition.
- 12.3 Vector supports the proposed change to bring distribution substations standard lives in line with transformer lives.

LV supplies

- 12.4 The 20 year life for LV Supplies is inconsistent with other LV assets e.g. LV cables are 45-70 years, LV customer service connections 45 years. The life should be at least 40 years.

Life extension

- 12.5 The additional requirements of A.31 to now provide a schedule of assets whose lives have been extended and the corresponding impact on the DRC of each asset class, if literally enforced, will create a substantial quantity of extra work for lines businesses with limited benefit.
- 12.6 While lines businesses can report on those assets whose lives have changed, the requirement to show each asset's impact on the DRC is time consuming and would require lines businesses to either build into their asset registers a mechanism to allow the lives to change back and forward from standard to revised values in order to calculate the DRC differential, or alternatively, the

lines businesses would need to hold multiple copies of the asset register for questionable benefit.

- 12.7 Vector considers it prudent to report on assets that have had their standard or remaining life figures altered and that a general calculation of the impact on the valuation is sufficient for auditing purposes. It would be useful for the Commission to comment on the level of detail it envisages this clause as requiring.

13 Excluded assets

- 13.1 Vector acknowledges that the extension of the valuation to include computer systems and asset management systems that are used for “real time network operation and control” is a positive, incremental step; however, that change does not sufficiently address the problem of lines businesses (by necessity) investing in management systems, even though a significant portion of the cost of these is excluded by the valuation rules.

14 Reporting requirements

- 14.1 Section 2.65 provides a substantial list of reporting requirements that lines businesses must provide in valuation reports.
- 14.2 Whilst Vector agrees with the premise of providing a level of transparency, a number of the items could result in lines businesses providing a significant level of detail for a range of matters, including non-standard costs, optimisations, application of multipliers. Again, a materiality threshold of say 1% of ODRC could be used to determine whether a significant level of reporting is required at a detailed level. For asset classes whose ODRC falls below this threshold, lines businesses should be able to report at a macro or broad level e.g. “an average multiplier of 1.xx was applied to y km of 6.6 kV lines because zzz”, rather than provide individual multipliers for each case.
- 14.3 Some clarification would also be useful on the level of detail required when the handbook requires schedules of asset quantities, classes to which multipliers etc have been applied. These requirements could result in pages of details that provide a lot of transparency but little value to the reader.

15 Unaddressed issues

- 15.1 Vector is concerned with the number of unaddressed substantive issues that were raised in our February 2004 submission. These issues were also raised by

a significant number of other participant's in their submissions. The lack of feedback from the Commission or its advisors has left many parties uncertain as to the Commission's rationale for maintaining its position on some items or whether their legitimate concerns have been reviewed or acknowledged.

Planning periods

- 15.2 PB made extensive comments in their December 2003 report (par 5.3) stating that there was "no substantive reason why the planning period should align with the optimum engineering planning period".
- 15.3 Vector, the ENA and a number of other submitters provided substantial arguments around the need to align the planning horizons with actual planning periods to stop the creation of perverse incentives for sub-optimal infrastructure investment. PB's rationale for not matching the optimisation period and the actual planning horizons were also challenged.
- 15.4 This material issue has not been addressed or acknowledged in either the revised handbook or accompanying reports. Vector notes that the Commission states in its accompanying paper (the Commission's paper) that issues of planning horizons will be addressed "during consultation on the information disclosure regime". Vector considers the separation of this fundamental valuation issue from the development of the ODV Handbook as inappropriate.
- 15.5 As stated above, the majority of submitters in the consultation process have already comprehensively challenged the current draft planning periods and the statements by the Commission's advisors purporting to justify their recommendations. It is questionable as to what benefit postponing the settlement of this issue will have or why the Commission has not chosen to take a view given the wealth of information and argument that has been put forward.
- 15.6 The fundamental valuation issue of planning periods should not be excluded from the process of finalising the ODV Handbook.

Requirement to Optimise Cables in Same Side Of Road

- 15.7 The last version of the draft handbook introduced a requirement to optimise existing underground cables to a single trench if they ran "close together" or "on the same side of any road or street". This requirement was extensively criticised as unworkable, inconsistent with a brownfields approach and encouraging perverse incentives by the majority of submitters.
- 15.8 The revised handbook continues to incorporate this optimisation requirement, with only cosmetic change (such that its substantive effect is the same as previously proposed). While the handbook allows "derating factors" to be considered "when making this assessment", the absolute requirement to optimise to a single trench (from the use of the word "must") negates any

flexibility that may have been intended. It should be noted that the with thousands of kilometres of cables it would be hugely onerous task for lines businesses to locate cables that are not in the same trench but on the same side of the road, undertake rating and loading assessments and determine whether or not they should be optimised.

- 15.9 Vector reiterates its previous submission that this new requirement should be dropped. If the Commission has actively decided to retain this new optimisation requirement, it would be helpful to understand why it has chosen to do so and the reasons for rejecting the substantive submissions that were provided on this issue.

Excluded Assets - Mobile Generators and Substations

- 15.10 A significant number of submitters responded to PB's comments regarding the exclusion of portable network assets – in particular mobile generators and substations. PB has not addressed, in the revised handbook, or in the accompanying report, these concerns and legitimate challenges to the assumptions used.
- 15.11 Vector reiterates that PB's justification for excluding these assets (namely that they are "potentially contestable" and should be allocated to the incremental business) is incorrect. Lines businesses face regulatory requirements to improve reliability and CPI-X limitations on their ability to raise revenue to cover these improvements. These assets provide a cost-effective way of improving supply quality e.g. instead of up-rating several single bank zone substations to double bank, lines businesses can invest in a mobile substation or generators at much lower cost. As such, it is inconsistent and inefficient that these assets should then not be treated as part of the asset base - especially when they are used to meet the lines businesses security of supply criteria. A limit on the extent of ownership of such assets for the core business may be appropriate; however, an outright prohibition for valuation purposes is non-sensical in Vector's view.

Overhead lines

- 15.12 While the revised draft handbook has now excluded lines businesses from having to provide documented evidence in the report for changed lives due to pole replacement (ref 2.5.2), para A.8 still requires documented evidence to be retained. Vector's record of pole replacement is held in the GIS (ie the pole information is updated in the GIS), which then provides the data to the valuation database. The wording of this paragraph could be interpreted as requiring piles of paperwork for pole changes. It should be adequate to show that an audited process for field capture and transfer into the GIS exists and on that basis accept the validity of data provided for ODV as being correct.

15.13 It should also be noted that Vector (and possibly other lines businesses) have, in the past, used a cost-weighted proportional age for overhead lines based on both pole ages and line ages. The draft handbook requirement to use only pole ages (thus ignoring line refurbishments) means line ages are going to shift. A literal interpretation of the reporting requirements of 2.5.2 could result in hundreds of pages of data for age adjustments due to this new methodology; not to mention the difficulties in determining where age adjustments may be due to pole refurbishments rather than the methodology change.

Zone Substations – Incoming Switchgear

15.14 Table A.1 does not include a category for 11kV **indoor** switchgear. In most New Zealand substations, outdoor 11kV switchgear would be the exception rather than the rule. Vector proposes that categories are either added to the table or replace the outdoor categories for the following:

- o Incoming Indoor Switchgear;
- o Transformer Indoor Switchgear;
- o Feeder Indoor Switchgear;
- o Bus Section/Coupler Indoor Switchgear.

15.15 Note these would have a 45 year life (extendible to 55 years) in accordance with clause A.42.

Replacement costs

15.16 While PB Power has increased the standard replacement cost for single circuit 11kV cables, the double circuit 11kV cables remain the same as the MED 4th Edition. It is only reasonable to assume that cost increases in trenching, cable material or labour that apply to single circuit should also apply to double circuit. Based on the cost increases for single circuit cables from the 4th edition, the double circuit costs should be revised as follows:

- o 11kV U/G DCct Heavy U/G Cables – from \$170,000 to \$180,000/km (note: Vector's FRS-3 replacement cost for this class is \$215,000/km);
- o 11kV U/G DCct Medium U/G Cables – from \$135,000 to \$154,500/km (Vector's FRS-3 replacement cost for this class is \$155,000/km).

Optimisation – Use of very low capacity or less than three phase lines

15.17 This is a particularly onerous task that is required of lines businesses, being to look at thousands of rural spurs to determine whether all the customers are single phase. In many cases, because they are in rural areas, customer addresses are difficult to locate on a GIS and hence match to transformers,

feeders etc. It is likely that in many cases lines businesses will not be able to determine whether ICPs on a given spur are single or three phase.

- 15.18 The marginal cost difference between three phase and SWER is \$4,000 per km. If a lines business had, say, 100km of three-wire spurs that could be identified as able to be optimised to single-phase, the optimisation would be in the order of \$400,000 or say \$200,000 once depreciation is taken into account. This is an immaterial optimisation, imposing significant resource cost for little benefit.
- 15.19 For these reasons, this optimisation requirement should be removed.

16 Transpower and optimisation

- 16.1 Vector does not consider it prudent or appropriate for the Commission to provide Transpower with a specific exclusion on the application of optimisation of its assets where projects have been approved by the Electricity Commission ("EC") – paragraph 2.35. As explained below, this underscores the importance of the Commission consulting with the EC on the handbook and, more generally, considering cross-cutting or interface issues between the Commissions.
- 16.2 Under Part F of the Rules, the majority of Transpower's investments are, in Vector's view, likely to be approved by the EC as a matter of course. This, however, should not give Transpower a perpetual right to avoid optimisation when assets are eventually bypassed, become stranded or otherwise become the subject of reduced utilisation.
- 16.3 The EC determines whether transmission investments are justifiable on the basis of either a reliability or economic test. Both tests are based on the status quo of the grid and the forward forecasts of demand; much the same as distribution lines businesses make their investment decisions. The valuation handbook already has a mechanism for assessing externalities that affect investment decisions and, hence, the standard optimisation rules (these include looking at whether a customer has requested a higher level of quality, the additional benefits of having higher rated assets in terms of reducing losses and also the total life cycle costs of a project versus an alternative). As such, there is no reason to grant an exclusive bypass of the handbook's optimisation rules for Transpower.
- 16.4 In addition, the revised handbook also makes assumptions about the allowable planning horizons to be used. While it has been comprehensively argued by submitters that it is inappropriate to use planning horizons that are shorter than actually used by planning engineers, the Commission's advisors have stated that the risk should fall on lines businesses. While Vector disagrees with this view, the granting of a blanket exemption for Transpower effectively allows them to exclusively use the actual planning horizon, which will be the basis for

justifying grid investments. This goes against the Commission's arguments stated for preventing distribution businesses doing the same, and also destroys the approach of comparable valuations that has been sited as an important driver of the valuation methodology.

- 16.5 Removing Transpower from the optimisation rules faced by all other lines businesses, who in effect weigh up the value of investing in the network much the same as the EC will on behalf of Transpower, effectively removes Transpower from having to provide an optimised valuation. This, in Vector's view, is unjustified and singles out Transpower for differentiated, more favourable treatment than for other lines businesses. The approach will also have the flow on effect of increasing the transmission charges faced by consumers as Transpower will determine its allowable revenue based on a non-optimised grid even where assets are bypassed or under utilised.
- 16.6 It should also be noted that the application of Part F gives the EC the ability to approve alternative transmission investments (that may be comprised of excluded assets such as mobile generation and substations). These investments can be undertaken by lines businesses and are, therefore, approved by the EC. A fair application of the current exemption from optimisation, if it were to remain (which Vector does not support), should cover all EC-approved investments.

END