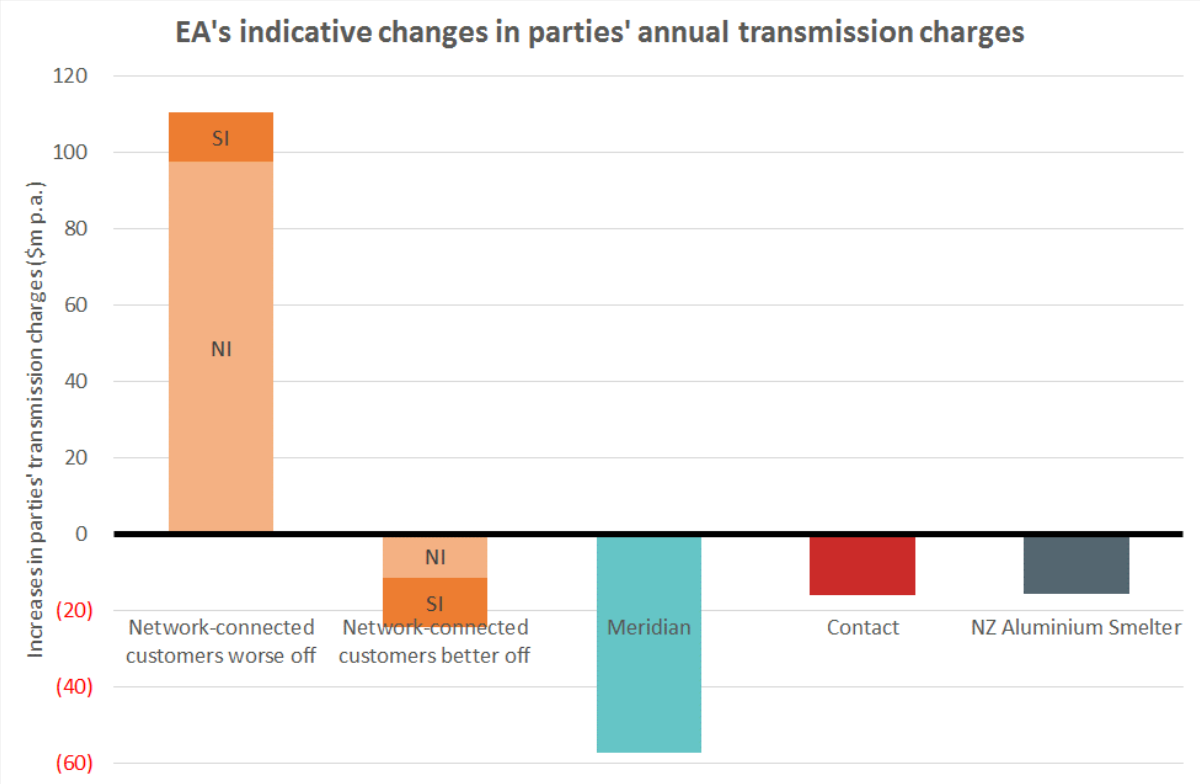
Tuesday 4 April 2017

Comments regarding the answers provided by Oakley Greenwood in the Q&A session on CBA calculations

Entrust does not consider the Oakley Greenwood Cost Benefit Analysis to be fit for purpose, or that it should be relied on to make a decision to change the TPM.

As shown in the chart below, the Electricity Authority's (EA) calculation of the price impacts of its proposals demonstrate that consumers across New Zealand will be worse off – especially in the North Island.



Consumers throughout NZ will be worse off by $600m Net Present Value (NPV) from the change in HVDC charges alone, for little or no additional service or benefit. This represents a significant wealth transfer to large corporates like Meridian and Contact. A decision with this magnitude of adverse impact on consumers needs a robust CBA, not a CBA riddled with errors.

The Electricity Authority needed a positive CBA to justify its proposals so OGW produced one. It appears the changes made to the HVDC CBA were made solely because the EA realised the CBA was actually negative. The appropriate response to the negative HVDC CBA, given the Authority is on record saying the existing CBA was robust and didn't require a single change (paragraphs 112 & 113, EA supplementary consultation paper dated 13 December 2016), would have been a decision to retain allocation of HVDC costs to South Island generators, not to change the results.

Deeply flawed process

We cannot understand why the Q&A session was added to the process after the consultation on the CBA and we found the experience with the Q&A session highly unsatisfactory and disconcerting, especially given the qualification around the Q&A process was limited to questions related to the "calculations in the CBA and not methodology".

Entrust, along with many other interested parties did not receive the e-mail responses until after the process had closed. This is despite the fact that the EA and OGW had been alerted that many interested parties were not receiving any e-mails from OGW on 28 March.

We understand very few questions were actually answered in the allotted time on 28 March, with several hours passing before the first of the questions was released. We don't understand how it could have taken nearly 24 hours to prepare the first of the responses, particularly given the brief and cursory nature of the responses that were provided.

Additionally, some responses were released at odd times, including late at night and around 5am NZ time. One didn't make it to questioners until Monday morning.

Many of the responses raised more questions than they answered, but because so few of the responses were provided before the cut-off time for questions, and then not provided to all interested parties that had registered, there was limited or no opportunity for follow-up questions. We understand the EA has refused to accept any follow-up questions.

Additionally, given these issues it is unacceptable that the EA has provided such a short timeframe to provide comment on the answers from the Q&A session. It is also extremely unfair of the EA to then shorten the deadline from 4pm on Tuesday 4 April to 2pm on Tuesday 4 April. A much better process would have been to have an open workshop where parties could have raised concerns in an open forum which would have provided transparency and reduced the impression of censorship and selective communications.

New CBA needed before EA decision

Based on submissions and the questions provided to OGW it is clear there are major errors. These aren't just the ones OGW dealt with when it made amendments to the HVDC CBA in order to get the cost-benefit back to a positive number. It is also clear, like the Sapere CBA before it, the OGW CBA doesn't estimate the costs and benefits of the Authority's actual proposal – it assumes the proposed area of benefit charge (for which charges are based on estimated benefits) will act exactly like an LRMC charge (for which charges are based on costs).

OGW's unsatisfactory responses to valid issues raised in both submissions and to the questions raised via the CBA Q&A confirm our concern the CBA is seriously flawed and needs to be redone.

The OGW responses appear to reflect an exercise in covering up the problems with its CBA, rather than using the Q&A process to improve the robustness of the CBA. We observed similar defensiveness from Sapere at the TPM conference in 2013 (as shown in the conference transcript). There was no concession the CBA had problems, but it was eventually thrown out by the EA. This needs to happen again.

CBA supports exclusion of sunk investment from AoB

If OGW were being upfront in its answers it would have confirmed that their results would have been exactly the same regardless of whether sunk transmission assets are included in the new AoB charge or not. This is because the OGW CBA benefits are predicated on how people would respond to future AoB charges for future investments, not past investment.

The upshot of this is that the CBA does not support applying AoB to existing investments such as the HVDC, NIGU and NAaN. The status quo options should prevail.

CBA supports leaving decisions on asset valuation to the new TPM development stage

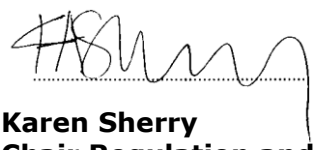
There has been a lot of comment that the EA's proposed Guidelines should be less prescriptive. The EA appears to acknowledge this. As a general rule, Entrust considers that the EA should only remove discretion in the Guidelines where this is supported by the CBA. This is relevant to OGW's responses on matters like asset valuation.

OGW was unable to comment on the impact that asset valuation decisions would have on the CBA. If OGW had modelled the Authority's proposal it could have simply changed the parameters, e.g. run the CBA model using different asset valuation methods, to test which options would be the best. Again, OGW should have been upfront about this in its responses.

The upshot of this is that the CBA does not support the Authority making decisions on detailed aspects of the proposal. This needs to be left to the new TPM development stage, if the Authority's flawed proposals go ahead. Pandering to corporate welfare by engineering an outcome enabling Meridian and others to pay as little as possible for the transmission services it receives is not grounds for the EA mandating a particular valuation method.

For further information, contact:
Helen Keir, Chief Operating Officer, Entrust
Phone: 09 929 4567

Kind regards,



Karen Sherry
Chair Regulation and Strategy