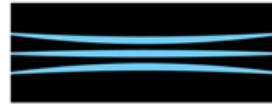


T R A N S P O W E R



Draft Government Policy
Statement on Electricity
Governance – February 2009

Submission by Transpower New
Zealand Limited

16 March 2009

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Introduction

- 1 Transpower welcomes the release by the Minister of Energy and Resources of a draft revised Government Policy Statement on Electricity Governance (the *Draft GPS*).
- 2 The most significant change for Transpower is the introduction of a streamlined process for transmission works under \$20 million. Transpower supports this initiative.
- 3 Transpower sees this as an important transitional step towards much needed improvements in the regulatory regime for transmission investment. Transpower accepts that economic regulation has an important role to play in delivering efficient investment in long-life transmission assets. However regulation must also recognise the current and urgent need for a sustained period of transmission investment in New Zealand. There is also a need to recognise that regulation itself can contribute to inefficiencies, and care is needed to ensure the impact of regulation is not counterproductive to overall efficiency objectives.
- 4 Set out below are Transpower's comments on the Draft GPS, and how Transpower considers the objectives and outcomes of the Draft GPS can be implemented by a change to the Electricity Governance Rules. In short, the minor transmission works provisions of the Draft GPS will lead to substantial improvements in the efficiency of Transpower's investment programme by allowing reprioritisation of projects and a more efficient allocation and operation of project resources, and contribute to overall lower costs of transmission maintenance, replacement and refurbishment and upgrade works.

A response to the need for more efficient and timely regulatory approval of minor upgrade works

- 5 Transpower has long been concerned about delays in the regulatory process for approval of important transmission upgrade work, but particularly so for relatively minor upgrade investments.
- 6 Minor upgrade projects are often driven by Transpower's on-going maintenance and replacement and refurbishment programmes. The costs and content of these programmes are regulated by the Commerce Commission under the Commerce Act (Transpower Thresholds) Notice 2008.
- 7 As maintenance and replacement and refurbishment plans are prepared, the option of upgrading the transmission assets to reflect demand growth is typically considered. As an indication, Transpower currently has plans for 28 projects over the next 12 months which are likely to have an upgrade element and are valued at between \$1.5 million and \$20 million. There are current plans for 79 projects of this type over the next 5 years. Of these 79 projects over the next 5 years, 35 are valued at less than \$5 million. Ultimately, the number of upgrade projects being considered will change over time, as opportunities to undertake prudent upgrades are more fully assessed. The number may increase or decrease, but will remain high.
- 8 These minor projects are thus often interdependent with maintenance or replacement and refurbishment works, which together with upgrade projects are necessary to minimise on-going risks to security of supply. These upgrade works include:

- 8.1 installation of new interconnecting transformers;
 - 8.2 new bus zone and circuit breaker protection;
 - 8.3 voltage support;
 - 8.4 thermal upgrades of existing lines.
- 9 Many of these projects have long been identified in Transpower's Annual Planning Report.
- 10 In some cases, these upgrades can only occur as part of refurbishment or replacement. For example, reconductoring a line due to the condition of the conductor presents an opportunity to increase the capacity of the line. The incremental cost of the increasing the conductor size is an upgrade. In other cases, the upgrade work may be associated with refurbishment or replacement work, but is technically distinct.
- 11 In both instances, undertaking these upgrade works at the same time as on-going maintenance, replacement or refurbishment provides opportunities for Transpower to capture project synergies. However, the current regulatory approval approach for minor upgrade works means the maintenance, replacement and refurbishment project timetable can be impacted, and efficiencies lost, due to the separate regulatory approval process required for the upgrade component of minor transmission works.
- 12 It currently takes between 3-9 months for Transpower to prepare a Grid Upgrade Plan for submission to the Electricity Commission for low cost upgrade proposals. There is a subsequent 2-6 months for regulatory approval by the Electricity Commission.
- 13 Experience to date suggests these delays are due to the effect of the Rules which:
- 13.1 require Transpower to carry out complex power systems and economic analysis of multiple investment options, in order to justify solutions that are often obvious, or to separate options that have substantially the same costs and benefits (that is, the net market benefits or costs are the same);
 - 13.2 leads to duplication by the Electricity Commission of analysis and consultation already undertaken by Transpower in preparing a grid upgrade plan;
 - 13.3 confuse the roles of Transpower as grid planner, and the Commission as reviewer and approver of grid upgrade plans submitted by Transpower;
 - 13.4 overall, result in extreme difficulty in avoiding over-analysis for small projects.
- 14 This ties up expert resources within Transpower, the Commission and industry participants, and delays the commencement of important, but low cost, works. It also places at risk of delay the timetable for related maintenance or replacement and refurbishment works.

- 15 In the past 12 months, Transpower has submitted and received approval from the Electricity Commission for eight Grid Upgrade Plan proposals, including four valued at less than \$20 million. All four projects valued at less than \$20 million have been approved by the Commission without any changes to Transpower's proposal.
- 16 While the Grid Upgrade and Investment Review Process (GUIRP), agreed between the Commission and Transpower, provides clarity as to the regulatory processes for large projects, the GUIRP does not address inherent problems with the Rules themselves, problems that are particularly, and disproportionately, acute in relation to low cost upgrade projects.
- 17 In October 2008, Transpower proposed a suite of changes to Section III, Part F of the Rules. Included in this suite was a proposal for a streamlined approval process for small investments. The intent of that proposed change, and the other changes, was to remove complexity and overlap, without changing fundamentally the underlying economic or reliability standards, the transparent consultation process or the economic efficiency objectives of Section III, Part F.

An effective streamlined approval process for minor works

- 18 Transpower considers an effective streamlined process for approval of minor transmission works will:
 - 18.1 recognise the need for grid investment proposals to:
 - (a) satisfy GEIP and an economic analysis commensurate with the size of the proposal;
 - (b) be consulted on in a transparent way with affected parties (including consumers);
 - 18.2 reduce the duplication of analysis and consultation by Transpower and the Commission, as Transpower (as grid planner) will undertake the analysis and consultation, with the Commission's role (as reviewer) being to confirm whether Transpower has taken into consideration reasonable issues raised during the consultation process;
 - 18.3 place appropriate incentives on Transpower to consult reasonably, ensuring the level of analysis of the investment is sufficient to ensure all material issues are considered;
 - 18.4 decrease the time and cost burden on Transpower, the Commission, other industry participants and affected parties relating to compliance with the Rules for low cost and less complex investments, when compared to the current approach to grid investment, thus freeing up resources within Transpower, the Commission, other industry participants and affected parties.
- 19 Transpower's own view remains that an appropriate threshold for identifying works suitable for the proposed streamlined approval process is in the order of \$40 - \$50 million. That said, a threshold set at \$20 million, if implemented without delay, will materially assist Transpower to advance several small but important upgrade projects over the next 12 months, all of which are reliability investments to avoid risks of outages.

Effective behavioural constraints remain

- 20 Transpower will continue to be subject to important constraints on its investment decisions for minor transmission works. Transpower's position as an SOE responsible for managing infrastructure critical to New Zealand's economic future does not allow for indifference as to the appropriateness of investments undertaken. As prudent owner and operator of the grid, Transpower plans investments consistent with good electricity industry practice and in doing so seeks to minimise costs to electricity consumers in New Zealand.
- 21 Under the streamlined process, Transpower must continue to meet standards of good electricity industry practice and minimum reliability standards for core grid assets. The requirement to consult will reveal any substantive issues not already identified and accounted for in Transpower's proposal. Transpower's response to issues raised during consultation will be scrutinised by the Electricity Commission, placing incentives on Transpower to ensure appropriate regard is had to concerns raised by submitters during the consultation process.
- 22 Transpower will also continue to be subject to regulatory oversight by the Commerce Commission. Transpower has every incentive to ensure it continues to achieve efficient transmission investment outcomes for electricity consumers, given the inevitable scrutiny that arises from being the sole transmission operator.
- 23 The existing processes for approving reliability and economic investments under Section III, Part F of the Rules will be retained, and can be used by Transpower if the complexities of a particular small project require a more comprehensive economic analysis. An example might be where a submitter raises a concern during the consultation process that cannot be adequately addressed by Transpower without undertaking the comprehensive economic analysis required by the GIT.

Comments on the Draft GPS

- 24 Transpower proposes some changes to the current wording of the Draft GPS in relation to minor transmission projects. The proposed amendments are set out in Appendix 1, along with reasons for the proposed amendment.
- 25 Generally, the comments are to:
- 25.1 clarify that the new streamlined approval process would apply only to grid upgrade projects, and not replacement and refurbishment, and general maintenance (which are covered by a separate category of expenditure under the Commerce Act (Transpower Thresholds) Notice 2008);
 - 25.2 provide greater clarity in the Draft GPS as to the respective roles of Transpower and the Commission under this new streamlined process;
 - 25.3 provide greater clarity in the Draft GPS as to the substantive requirements Transpower will be expected to meet in preparing and consulting on grid upgrade plans under the new streamlined process, and that the Commission will be expected to meet when considering approval of the upgrade plan.
- 26 We think this greater clarity will assist the Commission and stakeholders in proposing and commenting on specific changes to the Electricity Governance Rules to implement the new GPS provisions.

Implementation of the Draft GPS objectives and outcomes for minor transmission works

- 27 Transpower envisages that the “streamlined” approval procedure under the Rules for these minor transmission upgrade works would:
- 27.1 require Transpower to prepare a proposal that reflects GEIP, satisfies a commensurate economic analysis and (for reliability investments on the core grid) meets the “n-1” reliability standard;
 - 27.2 require Transpower to consult on the commensurate economic analysis, whether the proposal reflect GEIP, and (in the case of reliability investments for the core grid) whether the proposal meets the n-1 reliability standard;
 - 27.3 provide that proposals will be approved if the Commission is satisfied that Transpower’s proposal reflects a reasonable application of GEIP, meets the n-1 reliability standard (in the case of a core grid reliability investment) and Transpower has had regard to views of stakeholders received during the consultation period.
- 28 Transpower considers all the above principles are consistent with the existing purposes of the grid upgrade and investment rules of Section III, Part F, and can be implemented quickly. That is, the justification for the existing Section III, Part F rules applies equally to a “streamlined” process with the above features.
- 29 To further assist with the swift implementation of the new GPS, set out in Appendix 2 is a proposed set of new rules that Transpower considers will effectively implement the Government’s objectives and outcomes for minor transmission works.

Transpower’s planning processes in response to the Draft GPS

- 30 Set out in Appendix 3 is a proposed step by step process Transpower would follow in planning and seeking approval by the Commission for minor transmission upgrade works under this streamlined process. This is intended to be a flexible process that captures what Transpower considers to be the key elements of the Draft GPS on minor transmission works:
- 30.1 the identification of the need for the investment, either in advance in Transpower’s Annual Planning Report, or on a case by case basis;
 - 30.2 appropriate and commensurate economic analysis supporting the upgrade proposal (which, as noted in Appendix 3, Transpower envisages will include minimal options analysis if the appropriate solution is clearly evident, but in other cases will include the identification and consideration of alternative options where alternatives exist that are consistent with good electricity industry practice);
 - 30.3 ensuring investment in the grid continues to reflect good electricity industry practice, and meets minimum reliability requirements for the core grid;
 - 30.4 the flexibility to include multiple upgrade proposals, identified as good electricity industry practice on a “policy” basis, but which can still be justified as a cost effective way to meet minimum reliability requirements and good electricity industry practice;

- 30.5 an open and transparent process, based on consultation with interested parties;
- 30.6 ultimately, scrutiny by the regulator to ensure Transpower has due regard to the views of interested parties.

Benefits of the streamlined process

- 31 The estimated aggregate cost of the minor upgrade works over the next 5 years is approximately \$530 million, an amount which could be lower or higher as new minor upgrade projects are identified. Much of this investment cost will reflect the replacement or refurbishment objective of the works, with the upgrade component being a smaller component of the total project cost.
- 32 The overall regulatory objective will be achieved if opportunities for efficiencies in these total project costs are maximised.
- 33 The new streamlined process will provide Transpower with more certainty in long-term grid investment planning for maintenance, replacement and refurbishment and upgrades to the transmission grid, by facilitating prompt regulatory approval for minor upgrade works. This will:
 - 33.1 reduce the risk of delay in proceeding necessary maintenance, replacement and refurbishment of the grid due to delay in obtaining separate regulatory approval for an upgrade component of the works;
 - 33.2 enable significant improvements in Transpower's resource planning (both internally and by key contractors), including allowing Transpower to more efficiently manage and maintain staffing and contractor levels around a more foreseeable investment plan, and to grow skill levels;
 - 33.3 enable improvements to Transpower's procurement strategy by, for example, allowing larger supply contracts;
 - 33.4 allow better coordinated and more efficient programmes of work, by (for example) exploiting the economic synergies arising from, and risk avoidance benefits of, maintenance, replacement and refurbishment "policy" work on a grid asset being combined with upgrade work on this or other related assets, allowing larger packages of works spread over time and scheduled to optimise outage planning;
 - 33.5 overall, contribute to cost savings and lower construction risks.
- 34 Transpower estimates that the new streamlined process will reduce the time needed to obtain regulatory approval by 40%-80% per project, when compared with the current 5-15 months per project under the current Rules. This is based on the following assumptions:
 - 34.1 many minor investment works have already been identified in the Annual Planning Report (which is already widely consulted on with industry in order to identify investment need);

- 34.2 many minor investment works could be progressed on a “policy basis”, without detailed consideration of alternatives where no reasonable alternative consistent with GEIP exists (for example, Transpower’s current bus coupler investment programme);
- 34.3 the new streamlined process includes a 3-4 week period for consultation, with 3 weeks for approval by the Commission.
- 35 This reduction in time and complexity of the analysis needed to justify minor upgrade works proceeding will also:
- 35.1 reduce the associated direct costs to Transpower and the Commission of obtaining regulatory approval for minor investment works;
- 35.2 allow resources within Transpower and the Commission to be focussed on larger cost projects.
- 36 While it is difficult to provide an accurate estimate of indirect cost savings or efficiency gains, Transpower is strongly of the view that these cost savings and efficiency gains are real and obtainable through improved regulatory processes. Given that Transpower’s annual capital spend on replacement and refurbishment and minor upgrade projects (valued at less than \$20 million) is expected, over the coming years, to be in the order of \$225 million per year, efficiency gains of as little as 1-5% will result in investment cost savings of \$3-11 million per year.
- 37 This does not include additional benefits from increased security and reliability of the grid and any resulting gains from avoidance of transmission constraints and increased business confidence.

Transpower’s longer term vision for regulation of transmission investment

- 38 Transpower considers that a key benefit of the Draft GPS on minor transmission works is that it can be implemented quickly through a rule change to Part F of the Rules in a manner consistent with the existing requirements of the Commerce Act (Transpower Thresholds) Notice 2008. In particular, investments approved by the Electricity Commission under the “streamlined” process would continue to be treated as “Part F Capex” under the Threshold Notice. Hence, there would be no need for changes to the current terms of the Threshold Notice agreed between Transpower and the Commerce Commission in 2008.
- 39 Transpower has proposed over the longer term that the transmission investment regulatory regime should move away from the current project-by-project approach operating under a dual-regulator model, to a single regulator being responsible for approving Transpower’s proposed multi-year revenue path, including an ex ante approved multi-year capex programme.
- 40 However, in the context of the current regime, Transpower supports the proposed changes as they relate to minor upgrade works under \$20 million. We do so because we think the process described in the GPS has the potential to facilitate the timely regulatory approval and delivery of necessary works at an important time for the electricity industry while maintaining efficient investment outcomes.

APPENDIX 1.1 – DRAFT GPS

Investment in minor transmission works

87. The Government's objective in relation to the investment in ~~and maintenance of~~ upgrades to the transmission network is to put in place a more streamlined process for the approval by the Electricity Commission of grid upgrades proposals by Transpower where the expected total cost of ~~a~~ the upgrade project is less than \$20M.
88. For all future small upgrade projects ~~which~~ with an expected cost less than \$20M the Government seeks the following outcomes:
- Transpower should develop and submit grid upgrade plans to the Commission for approval.
 - Transpower should be able to submit to the Commission plans that contain one or more upgrade projects.
 - Grid upgrade plans should ~~demonstrate~~ set out the need ~~rationalise~~ for the proposal and all expenditure, meet minimum reliability standards for the core grid, be supported by economic analysis Transpower considers to be commensurate with the expected level of expenditure, (operational, maintenance and capital) and taking into account good electricity industry practice for power system operation.
 - In developing grid upgrade plans Transpower should undertake the detailed planning role; it should consult with materially affected parties on the content of the grid upgrade plans, including the application of good electricity industry practice, the need and the supporting economic analysis, and have regard to all submissions ~~or objections~~ received prior to submitting the grid upgrade plan to the Commission.
 - Once the Commission has received a grid upgrade plan the Commission should approve the plan without undue delay provided it is satisfied that Transpower has complied with the process requirements to prepare a grid upgrade plan, and the consultation requirements above.
 - The Commission should not be required to assess and evaluate the merits (whether technical, economic or otherwise) of small investment plans ~~of~~ with an expected cost of a value less than \$20 million.
 - If Transpower wants to amend an approved grid upgrade plan it should follow the same process unless the total project cost under the amended plan exceeds \$20M. In that case, the standard process, as outlined in paragraphs 78 to 86, should apply.

APPENDIX 1.2 – REASONS FOR CHANGES TO DRAFT GPS

Proposed amendment to the Draft GPS	Reason for proposed amendment
<p>The Government's objective in relation to the investment in and maintenance of upgrades to the transmission network is to put in place a more streamlined process for the approval by the Electricity Commission of grid upgrades <u>proposals</u> by Transpower where the <u>expected</u> total cost of at the upgrade project is less than \$20M.</p>	<p>Clarifies that the new process relates to approval of upgrade proposals only (and not replacement and refurbishment, and maintenance expenditure, which is already effectively captured as "non-Part F capex" and other expenditure under Transpower's Commerce Act thresholds requirements).</p> <p>"Expected" reflects current both current language used in the Rules and practice by Transpower of seeking approval for cost recovery up to expected costs.</p>
<p>For all future small <u>upgrade projects</u> which <u>with an expected cost</u> less than \$20M the Government seeks the following outcomes:</p>	<p>Clarifies that the new process relates to approval of upgrade proposals only.</p> <p>"Expected" reflects current both current language used in the Rules and practice by Transpower of seeking approval for cost recovery up to expected costs.</p>
<p>Transpower should develop and submit <u>grid upgrade</u> plans to the Commission for approval.</p>	<p>Consistency of drafting</p>
<p><u>Transpower should be able to submit to the Commission plans that contain one or more upgrade projects.</u></p>	<p>Clarifies that Transpower can include multiple upgrade projects in a single grid upgrade plan consulted on. This will further improve the efficiency of the process and avoid unnecessary duplication of consultation materials, allowing for consolidation of upgrade proposals that share similar technical need and economic characteristics (e.g. the bus coupler upgrade proposals currently being consulted on by Transpower).</p>
<p>Grid upgrade plans should demonstrate <u>set out the need</u> rationale for the proposal and all expenditure, <u>meet minimum reliability standards for the core grid, be supported by economic analysis</u> Transpower considers to be commensurate with the expected level of expenditure, (operational, maintenance and capital) <u>and taking</u> into account good <u>electricity</u> industry practice for power system operation.</p>	<p>Clarifies the content requirements for a grid upgrade plan under this minor investment process (maintaining consistency with the key principles of the existing upgrade investment approval process), including:</p> <ul style="list-style-type: none"> • The "need" for the investment, meaning the technical need; • Evidence that the investment will meet minimum reliability standards for the core grid and is consistent with good electricity industry practice; • Commensurate economic analysis supporting the investment;

Proposed amendment to the Draft GPS	Reason for proposed amendment
<p>In developing grid upgrade plans Transpower should undertake the detailed planning role; it should consult with materially affected parties <u>on the content of the grid upgrade plans, including the application of good electricity industry practice, the need and the supporting economic analysis</u>, and have regard to all submissions or objections received prior to submitting the grid upgrade plan to the Commission.</p>	<p>Clarifies the subject matter of the consultation process.</p>
<p>Once the Commission has received a grid upgrade plan the Commission should approve the plan without undue delay provided it is satisfied that Transpower has complied with the <u>process requirements to prepare a grid upgrade plan, and the consultation</u> requirements above.</p>	<p>Clarifies that the Commission's approval relates to the consultation requirements for minor transmission investments set out in the GPS</p>
<p>The Commission should not be required to assess and evaluate the merits <u>(whether technical, economic or otherwise)</u> of small investment plans of <u>with an expected cost of a value</u> less than \$20 million.</p>	<p>Clarifies that "merits" captures technical and economic merits. This is consistent with the underlying intention that this minor transmission approval process be driven by effective consultation.</p>

APPENDIX 2 - PROPOSED NEW RULE

Approval of minor transmission investments

1 Purpose

This rule set out the processes for consultation, and Board approval of minor transmission investments proposed by Transpower.

2 Consultation

2.1 Transpower must consult with persons who are representative of the interests of persons likely to be substantially affected by a minor investment proposal, on:

2.1.1 the need for the investment;

2.1.2 whether the investment reflects GEIP;

2.1.3 if the investment is a reliability investment relating to the core-grid, whether the investment meets the GRS;

2.1.4 an economic analysis relating to the proposed minor transmission investment that Transpower considers to be commensurate with the estimated capital expenditure required for the minor transmission investment.

2.2 Before Transpower submits minor investment proposals to the Board for approval, Transpower must have regard to any submissions made to Transpower during consultation.

2.3 Transpower may submit to the Board for approval a proposal containing more than one minor transmission investment.

3 Board approval of minor transmission investments

3.1 The Board must review the submissions made to Transpower during the consultation process and whether Transpower has had reasonable regard to those submissions.

3.2 If the Board is not satisfied that Transpower has had reasonable regard to any submission, the Board may direct Transpower to provide further explanation as to how Transpower has had regard to the submission.

3.3 Transpower may amend or introduce new minor transmission investments in response to the Board's requests at 3.2.

3.4 The Board must approve proposed minor transmission investments where the Board is satisfied that:

- 3.4.1 The proposed investment reflects a reasonable application of GEIP;
 - 3.4.2 If the minor transmission investment is a reliability investment relating to the core-grid, the proposed investment meets the GRS;
 - 3.4.3 Transpower has had reasonable regard to any submissions received by Transpower on the proposed investment and.
- 3.5 If within 3 weeks of the submission to the Board of a minor investment proposal, the Board has not given notice that the Board approves the minor transmission investments or that Transpower has not had reasonable regard to a submission made to Transpower in respect of a minor transmission investment, the Board shall be deemed to have approved the minor transmission investments contained in the proposal.

APPENDIX 3 – PROPOSED PLANNING AND APPROVAL PROCESS FOR MINOR TRANSMISSION WORKS

PROPOSAL – Upgrade only

Step 1	Need	<ul style="list-style-type: none"> Needs case referenced to Annual Planning Report (APR) Additional justification for new upgrades not in APR Dependencies with related asset refurbishment / replacements identified
Step 2	Timing	<ul style="list-style-type: none"> Forecasts consistent with the SOO or changes need to be justified Timing dependencies with other work programmes to be identified
Step 3	Options	<ul style="list-style-type: none"> Minimal options analysis if preferred solution is evident (rationale explained) Practicable options identified and considered in all other cases Options consistent with GEIP / Transmission Code
Step 4	Economic Analysis	<ul style="list-style-type: none"> Standard solution / standard costs for less complex projects NPV analysis to compare practicable options where the above doesn't apply Broader range of specific cost / benefit factors considered as appropriate Rationale for level of economic analysis applied subject to consultation
Step 5	Selection of Preferred	<ul style="list-style-type: none"> Preferred solution identified by Transpower Maximum Allowed Cost (MAC) calculation refined
Step 6	Consult	<ul style="list-style-type: none"> Consultation on Transpower's proposal and supporting analysis, including: <ul style="list-style-type: none"> needs case / planning assumptions / options analysis (where appropriate)/ economics analysis and project least cost / delivery analysis Consultation period minimum of 2-3 weeks Consultation on single or multiple-projects
Step 7	Refinement	<ul style="list-style-type: none"> Issues resolution (further consultation or bi-laterally)
Step 8	Submit	<ul style="list-style-type: none"> Transpower submits GUP with supporting information EC confirms that appropriate consultation process has been followed and the extent to which consultation issues have been resolved / considered
Step 9	Deemed Approval	<ul style="list-style-type: none"> EC decision within 3 weeks of submission <u>Approved / Further Consultation Required / Not Approved</u> EC approval for individual projects based on Transpower's proposed MAC

TRANSPOWER

STAKEHOLDERS

EC

* **The Scope of the proposed process applies to grid upgrades with a total project cost (P50) of less than \$20m. It does not apply to replacement and refurbishment and minor upgrades (less \$1.5m) which are subject to scrutiny by the Commerce Commission.**