



# MAJOR ELECTRICITY USERS' GROUP

22 September 2017

Keston Ruxton  
Manager, EAD Regulation Development  
Regulation Branch  
Commerce Commission  
By email to [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz)

Dear Keston

## **MEUG submission on Transpower capex input methodology incentive mechanism**

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commission consultation paper, Transpower capex input methodology review – Emerging views on incentive mechanisms, 1 September 2017.<sup>1</sup>
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.
3. The following section headers align with the summary questions the paper seeks views on.<sup>2</sup>

### **Emerging view to move to a symmetrical ex-ante expenditure regime for major capex**

4. MEUG agrees with the proposal to move to a “pure” ex-ante regime for major capex consistent with the ex-ante regime that already applies for base capex. Adopting a pure ex-ante regime goes hand-in-hand with using a P50 cost estimate instead of P90 for major capex approved allowances.
5. We do not agree with automatically carry over the existing policy that the ex-ante incentives should be symmetrical. The paper notes there are incentives that affect Transpower's capex decision making outside of the Capex IM that may have a bias towards capex rather than opex.<sup>3</sup> The list of non-IM incentives or factors that can lead to a bias in Transpower choosing solutions to consider recognises the asymmetry of countervailing power due to weak incentives on EDB to scrutinise Transpower's plans and projects even though EDB are the primary contractual counterparties to Transpower. The weak incentive results from the “pass through” cost mechanism.

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<sup>1</sup> Document URL <http://www.comcom.govt.nz/dmsdocument/15710> at <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/transpower-input-methodologies/capex-input-methodology-review/>,

<sup>2</sup> Commission paper, paragraphs 86.1 to 86.8.

<sup>3</sup> Ibid, paragraph 53.

6. The paper says “the cumulative impact of all the incentives on Transpower investment decisions is unclear” and cites the example where an opex solution may be preferred because a capex solution might have stranding risk. MEUG suggests an estimate of the direction and the cumulative effects is needed to ensure an appropriate offset is considered for the IM incentives mechanism. It is insufficient for the Commission to list the non-IM factors that influence incentives on Transpower and then assume because no party makes submissions on the materiality of those factors that they need not be considered. Absent quantitative estimates being made a qualitative estimate would be better than none. On that basis MEUG’s qualitative view is that overall the non-IM incentives are likely to be biased in favour of capex over opex and for Transpower to select safe rather than innovative options because of weak countervailing power. Hence, there is a case to consider asymmetric incentives.

#### **Emerging view to use P50 cost estimate for major capex allowances**

7. As noted in paragraph 4 above we agree with changing to a P50 cost estimate.

#### **Proposal to allow incentives to be tailored for major capex or listed projects**

8. We are open to this being considered further but cautious to agreeing until we can see the details of how it might work. That caution leads us to support the commentary in the paper that “our initial view is that a lower incentive rate would be an exception for listed projects.”<sup>4</sup>
9. In relation to tailored ex-ante set incentives for major capex we prefer Transpower to use a staged approach to progressively gaining regulatory approval because that provides a discipline for engagement with interested parties at each stage of large complex major capex projects with all parties knowing before-hand the default ex-ante incentive rate. It would be difficult to design and have a better outcome, given all the other intricacies associated with large complex major capex proposals, of a tailored one-shot incentive rate at the outset for a large project compared to the benefits of consultation and ability to modify the project using a staged approach.

#### **The need for greater engagement by Transpower and opportunity for external scrutiny on some projects that are currently part of base capex**

10. MEUG agrees with the focus in the paper on base capex investment projects. We have no experience of Transpower failing to consult for investment projects within base capex when they possibly should have. It is unclear though how Transpower selects parties to consult with for these relatively small one-off projects. Sometimes MEUG is consulted and other times MEUG only becomes aware of these base case investment project consultations through MEUG members forwarding materials. As far as we know there is no public Transpower web page that lists all current or forthcoming consultations on base capex investment projects. As all consumers pay for base capex there is a case any affected consumer can opt into a consultation on any base capex investment project rather than Transpower selecting parties to be consulted.

#### **The criteria that might apply when deciding which (base capex) projects should be subject to greater consultation and scrutiny**

11. We have no suggestions.

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<sup>4</sup> Ibid, paragraph 47.

**Emerging view not to change the \$20m threshold for major capex projects**

12. MEUG agrees with the approach by the Commission.
13. MEUG agrees with other submitters that there are risks with electricity monopolies “competing” anti-competitively with or operating inefficiently relative to generators, retailers and customers that could provide distribution-alternative or transmission-alternative services. In our view that risk lies with EDB not Transpower.
14. If there are risks of Transpower failing to consider lower cost non-transmission options, then the solution lies in first, finding a cost-effective mechanism and criteria to allow greater engagement by Transpower and opportunity for external scrutiny on some projects that are currently part of base capex as discussed in the preceding two sections. Second, to design an effective new ex post incentive mechanism as discussed in the next section.

**Emerging view to replace the policies and processes incentive in the capex IM with targeted qualitative information disclosure**

15. We agree with the view of Transpower that the current “policies and processes” incentive is ineffective.<sup>5</sup> Targeted qualitative information disclosure would be an improvement as would MEUG’s suggestion of targeted ex-post reviews of particular projects.<sup>6</sup> The choice of either or both targeted qualitative information disclosure and or targeted ex-post reviews depends on the net benefit they derive and that depends on their design and implementation.
16. Ex-post information disclosure requirements risk adding unnecessary compliance costs when the likely incentive effect on Transpower may be negligible as it will likely change processes and policies as part of ongoing continuous improvements. This also leads to another problem with information disclosure that it may not be adaptable as processes and policies change. A more generic problem with information disclosure is the length of time before issues are identified and published in a disclosure. It’s a very long feedback loop.
17. A well designed targeted ex post review of material (high cost or high risk) or precedent setting projects would give more timely and practical insights and opportunity for working solutions to issues found in dialogue between Transpower and interested parties. MEUG accepts there are challenges in deciding how to identify material and or precedent setting capital projects for an ex post review where there is a high probability the benefits of learnings found for future improvements will outweigh the cost of the review; nevertheless, it is still worth investigating.
18. An alternative approach to setting in the IM criteria and the mechanics for a targeted ex post review regime would be for Transpower to adopt, after consultation with customers and interested parties, a voluntary protocol. That approach is likely to be more amenable to adaptation, constructive buy-in by interested parties and lead to more timely improvements being adopted by Transpower.

Yours sincerely



Ralph Matthes  
Executive Director

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<sup>5</sup> Ibid, paragraph 81.

<sup>6</sup> Ibid paragraphs 83 and 84 respectively.