



COMMERCE COMMISSION

Revised Transpower Process Paper

Network Performance Branch
Commerce Commission
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NEW ZEALAND

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1 INTRODUCTION

1.1 Purpose

- 1.1 The purpose of this paper, being the Revised Transpower Process Paper (Revised Process Paper), is to set out the Commerce Commission's (Commission) updated view on the process that the Commission should follow in:
- making its recommendation to the Minister of Commerce (the Minister) on the type of price-quality regulation to apply to Transpower following the expiry of the existing settlement agreement; and
 - determining the input methodologies that apply to Transpower.
- 1.2 This paper reconsiders the process set out in the Commission's Transpower Process and Recommendation Discussion Paper released on 19 June 2009 (Process and Recommendation Paper) in light of the submissions on the Process and Recommendation Paper, the Ministerial review of electricity market performance (the Electricity Market Review) and the timing for determining input methodologies for other sectors.

1.2 Consultation on this paper

Other relevant Commission consultation papers

- 1.3 The Commission is also releasing a process paper entitled 'Input Methodologies – Update on Process' in conjunction with this paper. The Input Methodologies – Update on Process paper sets out the process for determination of input methodologies for the sectors covered by Part 4 of the Commerce Act 1986 (the Act), as amended by the Commerce Amendment Act 2008 (the CAA).
- 1.4 The revised process for Transpower set out in this paper is consistent with the process set out in the Input Methodologies – Update on Process Paper.

Submissions

- 1.5 Submissions are invited on the revised process set out in this Paper. To assist interested parties in making submissions, the Commission has set out questions on which it invites comment.
- 1.6 Submissions on this paper should be received by the Commission no later than 5pm on Monday, 21 December 2009 (due date). All submissions should be supported by documentation and evidence, where appropriate.
- 1.7 In order to meet the requirements prescribed in the Act, the Commission relies on submissions being provided by the due date. The Commission will only allow extensions beyond the due date if the submitter provides good reasons in writing. If submissions are received after the due date and an extension has not been granted, the Commission may not be in a position to adequately consider submissions for the next stages of the project.
- 1.8 To foster an informed and transparent process, the Commission intends to publish all submissions on its website. Accordingly, the Commission

requests an electronic copy of each submission and requests that hard copies of submissions not be provided (unless an electronic copy is not available). Submissions should be sent to:

NPB@comcom.govt.nz; or
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Confidentiality

- 1.9 The Commission discourages requests for non-disclosure of submissions, in whole or in part, as it is desirable to test all information in a fully public way. It is unlikely to agree to any requests that submissions in their entirety remain confidential. However, the Commission recognises there will be cases where interested parties making submissions may wish to provide confidential information to the Commission.
- 1.10 If it is necessary to include such material in a submission the information should be clearly marked and preferably included in an appendix to the submission. Interested parties should provide the Commission with both confidential and public versions of their submissions. The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.
- 1.11 Parties can also request that the Commission makes orders under s 100 of the Act in respect of information that should not be made public. Any request for a s 100 order must be made when the relevant information is supplied to the Commission and must identify the reasons why the relevant information should not be made public. The Commission will provide further information on s 100 orders if requested by parties, including the principles that are applied when considering requests for such orders. Any s 100 order will apply for a limited time only as specified in the order. Once an order expires, the Commission will follow its usual process in response to any request for information under the Official Information Act 1982.

2 STATUTORY FRAMEWORK

2.1 Introduction

2.1 The Commission's Process and Recommendation Paper set out the key provisions relating to the regulation of Transpower under Part 4 of the Act. A summary of those provisions is set out below.

2.2 Regulation of Transpower

Type of regulation

2.2 On 13 May 2008, the Commission accepted an administrative settlement from Transpower in respect of breaches of the thresholds under Part 4A of the Act. Although Part 4A has now been repealed by the CAA, Transpower continues to be subject to this administrative settlement until it expires on 30 June 2011.

2.3 Part 4 of the Act does not specify which type of price-quality regulation will apply to Transpower. Section 54M(3) requires that, before Transpower's administrative settlement expires on 30 June 2011, the Commission must recommend to the Minister that an Order in Council be made under s 52N declaring that Transpower be subject to either:

- default/customised price-quality regulation, under subpart 6; or
- individual price-quality regulation, under subpart 7.

2.4 Transpower will be subject to price-quality regulation once the Governor-General (upon the Minister's recommendation) makes the Order in Council declaring the type of price-quality regulation to apply to Transpower and the Commission makes a s 52P determination applying the regulation to Transpower.

2.5 Section 54M(4) provides that Subpart 2 of Part 4 (Regulating Particular Goods or Services), except the provisions relating to inquiries, applies to the process for imposing price-quality regulation and making the s 52P determination for Transpower.

2.6 Section 54M(5) provides that if the Order in Council declares that Transpower is subject to default/customised price-quality regulation, the Commission must set a default price-quality path in accordance with s 53P. If the Order in Council declares that Transpower is subject to individual price-quality regulation, the provisions under subpart 7 (individual price-quality regulation) apply.

2.7 Section 54M(6) provides that the only requirements that may be set in respect of Transpower's quality standards are requirements that give effect to quality standards set by the Electricity Commission.

2.8 The appropriate type of price-quality regulation will be applied to Transpower once the Commission makes its s 52P determination. This determination must be made as soon as practicable after the Order in Council is made (s 52P(2)). The Commission has calculated that, to avoid a gap in the price-quality regulation of Transpower, by determining a price-quality path taking effect from the end of the administrative settlement, the s 52P

determination will have to be made by November 2010. This allows Transpower time to set its prices for the first year of the regulatory period following the administrative settlement and notify its customers of those prices.¹

Input methodologies

- 2.9 Section 52U provides that the Commission must determine input methodologies for the goods or services regulated under subparts 9 to 11 of Part 4 no later than 30 June 2010. Section 52U(2) provides that the Minister of Commerce (Minister) may extend this deadline, upon written request of the Commission, by up to 6 months. The Commission requested a 6 month extension and this was granted by the Minister on 10 December 2009. The revised process for determining input methodologies (including those for Transpower) is set out in the Commission's 'Input Methodologies - Update on Process Paper' released in conjunction with this paper.
- 2.10 In the Process and Recommendation Paper, the Commission stated the preliminary view that it should determine all input methodologies applicable to the type of price-quality regulation recommended for Transpower before making its recommendation to the Minister.² The Commission has reconsidered this approach due to two factors that have arisen following the release of that Paper. These factors are the Electricity Market Review and the extension to the date for determining input methodologies. These factors together with the revised Commission process for making the recommendation to the Minister and the information to be provided in the recommendation to the Minister are discussed in section 3 of this Paper.
- 2.11 In the Process and Recommendation Paper, the Commission stated that it is not required to determine input methodologies for matters relating to proposals, by Transpower, for a customised price-quality path (i.e. s 52T(1)(d)). As noted above, Transpower is not currently subject to default/customised price-quality regulation, and the Commission's preliminary view is that individual price-quality regulation would be more appropriate for Transpower. If, following consultation, the Commission decides to recommend default/customised price-quality regulation, the Commission would consult on and determine the matters in s 52T(1)(d).

Information disclosure

- 2.12 Transpower is subject to information disclosure regulation under Part 4 of the Act. Section 54I(1) provides that the s 52P determination specifying how information disclosure regulation will apply to Transpower must be made as soon as practicable after 1 April 2009. Until that time, s 54W provides that the current information disclosure requirements for Transpower (as set out in

¹ Transpower's pricing year is from 1 April to 31 March and its financial year is from 1 July to 30 June. Transpower currently sets its revenue requirement for a pricing year in October/November and notifies its customers of the new prices in November/December.

² Commerce Commission, Transpower Process and Recommendation Discussion Paper, 19 June 2009, p 12.

the Electricity (Information Disclosure) Requirements 2004) continue to apply.

3 PROCESS FOR REGULATION OF TRANSPOWER

3.1 Process and Recommendation Paper

3.1 In the Process and Recommendation Paper, the Commission set out the process it intended to follow in making its recommendation to the Minister and its preliminary view on the type of regulation to apply to Transpower following the expiry of the settlement agreement. The Commission's process for the regulation of Transpower included the tasks and indicative dates set out in the following table.

Phase	Task	Indicative date
Commission recommendation (undertaken in parallel with process for determining input methodologies)	Release draft Transpower recommendation, input methodologies draft determination, draft content of s 52 P determination.	Q1 2010
	Submissions on draft recommendation, input methodologies draft determination and s 52P content.	Q1 2010
	Cross submissions on draft recommendation, input methodologies draft determination and s 52P content.	Q1 2010
	Finalise input methodology determinations.	Q2 2010
	Commission final recommendation to Minister.	Q2 2010
Minister and Governor-General	Minister's decision on regulation to apply to Transpower.	Q4 2010
	Governor-General's Order in Council.	Q4 2010
Commission determination	Commission releases draft s 52P determination.	Q4 2010
	Submissions on technical drafting of s 52P determination.	Q1 2011
	Final s 52P determination published in the Gazette (including transitional period).	Q1 2011
Transpower set prices	Transpower prices (based on current settlement agreement) apply for the 2011/12 pricing year.	Q2 2011

Expenditure review (if individual or customised price-quality regulation)	Transpower submits expenditure information.	Q2 2011
	Commission's draft decision on expenditure.	Q3 2011
	Submissions on draft decision.	Q3 2011
	Commission's final decision on expenditure.	Q4 2011
Transpower pricing	Transpower calculates prices for 2012/13, based on applicable price-quality regulation and path.	Q4 2011
	Transpower advises customers of prices.	Q4 2011
	Transpower prices apply for 2012/13 pricing year.	Q2 2012

Table 1: Process set out in the Process and Recommendation Discussion Paper

3.2 The above dates were based on, among other things, the Commission's proposed approach to determine input methodologies for Transpower prior to making a recommendation to the Minister. The Commission has revisited this approach in section 3.4 of this Paper.

3.2 Submissions on Process and Recommendation Paper

3.3 The Commission received submissions on the Process and Recommendation Paper from Transpower, MEUG and PricewaterhouseCoopers (PwC), on behalf of 18 electricity distribution businesses.

3.4 Transpower, MEUG and PwC agreed with the Commission's proposed process. Specifically, the submissions supported developing input methodologies prior to making the recommendation to the Minister and the inclusion of a 12 month transitional period, based on the existing administrative settlement, to set the revenue requirement for the remainder of the regulatory period.

3.5 Transpower highlighted that, although it agreed with the proposed process, the timetable would be tight, particularly around setting the revenue requirement during the transitional year. Given the tight timetable, Transpower suggested there might be merit in Transpower submitting a draft expenditure plan to the Commission early in the transitional year (Q1 2011).

3.6 Transpower, MEUG and PwC also agreed that individual price-quality regulation would be more suitable for Transpower than default/customised price-quality regulation.

3.3 Factors impacting on the process

3.7 There are two factors that have arisen since the Commission released the Process and Recommendation Paper. These are the announcements on the Electricity Market Review by the Minister of Energy and Resources and the extension to the date by which input methodologies are required to be determined. The impact of these factors on the process of setting price-quality regulation for Transpower is discussed below.

Ministerial review of electricity market performance

- 3.8 In April 2009, the Minister of Energy and Resources appointed the ETAG to review the performance of the electricity market and governance arrangements and to make recommendations and improvements.
- 3.9 On 12 August 2009, the Minister of Energy and Resources released ETAG's preliminary report (ETAG Report).³ The ETAG Report made a number of recommendations, including:
- the Electricity Commission's approval of major grid upgrades should be transferred to the Commission as part of its overall regulation of Transpower under Part 4 of the Act, to ensure integrated consideration of transmission expenditure, performance and prices;
 - the reliability and service standards, transmission pricing methodologies, and the GIT should be set by a new Electricity Authority,⁴ that replaces the Electricity Commission;
 - the GIT should be amended to make it clearer, simpler and less prescriptive; and
 - the Minister would no longer be involved in accepting/rejecting the Electricity Authority's rules covering technical matters.⁵
- 3.10 Following the ETAG Report the Minister of Energy and Resources announced a number of changes to the electricity industry.⁶ These included the following governance initiatives.
- abolishing the electricity commission and replacing it with a slimmed-down Electricity Authority, with far fewer objectives and functions than the current Commission;
 - establishing a Security and Reliability Council to monitor Transpower's performance and advise on security of supply; and
 - transferring responsibility for grid upgrade approvals to the Commerce Commission.⁷
- 3.11 The majority of the changes announced by the Minister of Energy and Resources are contained in the Electricity Industry Bill which is to be introduced to the House of Representatives in December 2009.

³ Electricity Technical Advisory Group and the Ministry of Economic Development, *Improving Electricity Market Performance Volume one: Discussion paper*, August 2009.

⁴ The Minister of Energy and Resources and the Electricity Industry Bill refer to the Electricity Authority while the ETAG Report originally referred to the Electricity Market Authority.

⁵ Electricity Technical Advisory Group and the Ministry of Economic Development, *Improving Electricity Market Performance Volume one: Discussion paper*, August 2009, summary of the key recommendations set out on pages 35 and 36.

⁶ Minister of Energy and Resources, *Energy Sector Transformation to Benefit Consumers*, 9 December 2009.

⁷ Ibid.

- 3.12 The Electricity Market Review and the changes announced by the Minister of Energy and Resources impact on the treatment of Transpower's capital expenditure going forward and therefore how the capital expenditure mechanism will operate within the regulatory regime applying to Transpower. Until the passage of the Electricity Industry Bill, and until any consequently changes to the Act that have a bearing on the implementation of price-quality regulation for Transpower have been made, the Commission must proceed on the basis of the Act as it stands. Nevertheless, the proposed changes to the treatment of capital expenditure makes it difficult for the Commission to determine, with any certainty, the eventual capital expenditure mechanism that would apply to Transpower under either default/customised or individual price-quality regulation prior to making the recommendation to the Minister.

Timing for determining input methodologies

- 3.13 The Minister of Commerce has granted the Commission an extension to the deadline for determining input methodologies for regulated services under Part 4 of the Act. The revised timing for determining input methodologies for each of the sectors is set out in the Commission's Input Methodologies – Update on Process Paper, released in conjunction with this Paper.
- 3.14 As noted above, in the Process and Recommendation Paper, the Commission proposed to determine Transpower input methodologies prior to making the recommendation to the Minister. The Commission considered that, in order for the Minister to make his decision and the Commission to complete the steps required to set Transpower's revenue requirement prior to the expiry of the administrative settlement, the Commission's recommendation would need to be made by 30 June 2010. This, and the Commission's proposal to determine Transpower input methodologies prior to making its recommendation, would have required the Commission to determine all applicable input methodologies for Transpower by 30 June 2010.
- 3.15 However, given that the Commission has now been granted an extension to the deadline for determining input methodologies, this would mean determining the Transpower input methodologies prior to determining input methodologies for other sectors. The Commission considers that the preferred approach is to consult on the Transpower and Electricity Distribution Businesses input methodologies in parallel to allow any issues that are common to both sectors to be considered and addressed consistently when setting the input methodologies for those sectors.

3.4 Recommendation information and revised process

- 3.16 Section 54M(4) of the Act provides that Subpart 2 of Part 4 (Regulating Particular Goods or Services), except the provisions relating to inquiries, applies to the process for imposing price-quality regulation and making the s52P determination for Transpower.
- 3.17 Section 52K(2) states the matters that need to be included in a Commission recommendation following an inquiry. As set out in the Process and Recommendation Paper, the Commission considers that s 52K does not apply to the s 54M(3) recommendation process (because it is a provision relating to

inquiries). However, it provides guidance on the matters that need to be included in a recommendation to enable the Minister to make an informed decision. Specifically s 52K(2) suggests that the Commission should state the material provisions of the proposed price-quality path (refer to sub-section (g)).

- 3.18 The Commission considers that, in order to include the material provisions of the proposed price-quality path for Transpower, its recommendation to the Minister should include a brief description of the input methodologies that are likely to be applicable to Transpower (subject to consultation), a brief description of any other key building block components that are likely to apply to Transpower, and a brief description of how the input methodologies and other building block components would likely combine to form a price-quality path for Transpower.
- 3.19 The Commission considers that its recommendation to the Minister on whether default/customised or individual price quality regulation should apply to Transpower is not dependent on the Commission finalising the Transpower input methodology determinations. The input methodologies that apply to Transpower are unlikely to vary significantly depending on whether default/customised or individual price-quality regulation is recommended for Transpower.
- 3.20 In determining the description of how the input methodologies and other building block components would likely combine to form a price-quality path for Transpower the Commission has taken into account the general consensus amongst submitters that it is appropriate for the Commission to recommend that individual price-quality regulation should apply to Transpower following the expiry of the administrative settlement.

(1) Do you agree with the scope and level of information that the Commission intends to include in its recommendation to the Minister?
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Revised process

- 3.21 Given the factors set out above, the Commission considers that the recommendation to the Minister can be made in advance of determining input methodologies for Transpower and, therefore, in advance of the proposed recommendation date set out in the Process and Recommendation Paper. If the Minister requires further information on the Commission's recommendation, he may request this from the Commission under s 52L of the Act, before making a final decision. The revised process reflecting this approach is set out below.

Phase	Task	Indicative date
Commission recommendation and draft input methodologies	Release Transpower Revised Process Paper covering the process for the regulation of Transpower under Part 4 of the Act.	10 Dec 2009
	Submissions on Transpower Revised Process Paper.	21 Dec 2009
	Release draft recommendation to Minister.	Feb 2010
	Submissions on draft recommendation to Minister.	Feb 2010
	Workshop on Transpower.	Mar 2010
	Commission's final recommendation to Minister.	Apr 2010
	Release draft Transpower input methodologies and draft s 52P determination.	May/June 2010
Minister and Governor-General ⁸	Minister's decision on regulation to apply to Transpower.	July 2010
	Governor-General's Order in Council.	Aug 2010
Commission s52P determination and Transpower input methodologies	Commission finalises Transpower input methodology determinations. ⁹	Oct 2010
	Consultation on s 52P determination technical drafting.	Oct 2010
	Summary of Commission's final s 52P determination published in the Gazette.	Nov 2010
Transpower pricing for 2011/12 year	Transpower calculates prices for 2011/12 year. ¹⁰	Nov 2010
	Transpower advises customers of prices for 2011/12 year.	Dec 2010
Expenditure review (if individual or customised price-quality regulation) ¹¹	Transpower submits expenditure information for remainder of regulatory period.	Q1 2011
	Release draft decision on expenditure.	Q3 2011
	Submissions on draft decision.	Q3 2011
	Commission's final decision on expenditure.	Q4 2011
Transpower pricing for remainder of regulatory period	Transpower calculates prices, based on price-quality regulation and path.	Q4 2011
	Transpower advises customers of prices.	Q4 2011
	Transpower prices apply.	Q2 2012

Table 2 Commission Revised Process

3.22 The above dates are based on the Commission's revised process of making the recommendation to the Minister prior to determining the input methodologies for Transpower.

⁸ The proposed dates for the Minister undertaking a review of the Commission's recommendation and making a decision and the Governor-General making an Order in Council are dependent on the process adopted by the Minister and the Governor-General. Any change to these dates could impact on the subsequent dates set out in table 2.

⁹ See the Commission's paper entitled Input Methodologies – Update on Process for the approach for determining input methodologies.

¹⁰ Transpower's pricing year is from 1 April to 31 March and its financial from 1 July to 30 June. Transpower currently sets its revenue requirement for a pricing year in October/November and notifies its customers of the new prices in November/December.

¹¹ An expenditure review for a customised price-quality path would occur only if Transpower was subject to a default price-quality path and made a proposal to the Commission for a customised price-quality path.

- 3.23 As with the original process, the revised process aligns the process for determining Transpower's input methodologies with the process for determining input methodologies for electricity distribution businesses.¹² This approach allows any issues that are common to both sectors to be considered and addressed consistently when setting the input methodologies for those sectors.
- 3.24 The revised process continues to allow sufficient time for the Minister to consider the Commission's recommendation and to make a recommendation to the Governor-General, for the Governor-General to make the Order in Council, and for the Commission to make the s 52P determination applying the regulation to Transpower, prior to the expiry of the administrative settlement. Sufficient time has also been allowed for the Minister to request further information from the Commission if necessary.
- 3.25 The revised process continues to include a transition period from the expiry of the settlement agreement on 30 June 2011 to the end of the 2011/12 financial year on 30 June 2012. The Commission is proposing to use the transition period to set Transpower's revenue requirement for the remainder of the regulatory period and for Transpower to calculate and notify its customers of any price changes so that those prices take effect from 1 April 2012.

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|-----|---|
| (2) | Do you agree that the Commission's recommendation to the Minister on default/customised or individual price quality regulation applying to Transpower is not dependent on the Commission finalising the Transpower input methodology determinations? |
| (3) | Do you agree that the Commission's revised process for making the recommendation to the Minister is more appropriate than that previously proposed given the uncertainty around the treatment of Transpower capital expenditure and the revised timetable for the determination of input methodologies? If not, what changes do you consider should be made, and why? |

¹² This is in accordance with the Commission's paper entitled Input Methodologies – Update on Process for the approach for determining input methodologies.