



18 December 2018

Calum Gunn
Regulation Branch
Commerce Commission
Wellington

Dear Calum

Submissions – Transpower IPP reset process, framework and approach

We appreciated stakeholder engagement on the Commerce Commission’s RCP3 determination process. Understanding the perspectives of our direct customers, end-users and other stakeholders is important to ensure the Commission’s price determination processes are robust. There were four submissions, from Genesis, Meridian, MEUG and Vector.

The purpose of this letter is to clarify our perspectives as we move forward through the Commission’s process.

What we have done so far

Transpower has consulted on [service measures for RCP3](#), the [RCP3 draft proposal](#) (including price-quality trade-off testing), hosted a [pre-proposal focus group session](#) and introduced independent verification.

Specifically, we put a significant effort to accommodate independent verification into our proposal development, so it can inform the Commission’s evaluation (as it was useful for our proposal development).

The independent verification process comprised:

- tripartite meetings;
- draft and final reports shared with the Commission and Transpower; and
- a verifier workshop between the Commission and the Independent Verifier.

The [Independent Verification Report](#) has been made available to stakeholders with our proposal, as has the [Deed relating to RCP3 Independent Verification](#) between the Independent Verifier, the Commission and Transpower.

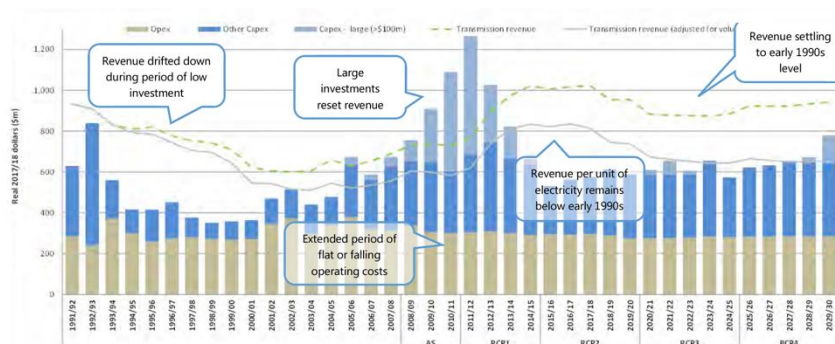
We consider the Commission has had extensive insight into the approach we undertook to develop our RCP3 proposal, which has brought significantly more transparency into the regulatory price control process.

Clarifying the impact of transmission on residential electricity prices

Any discussions on the longer-term impact of transmission investment on prices needs to be based on robust information. A view of transmission revenues and costs over time, covering full reinvestment cycles is provided by the chart below. We provided it to our stakeholders in the recent consultation on our RCP3 proposal.¹

Appendix 3 – Long-term trends

Given the long lives of transmission assets, it is useful to put the coming decade into perspective by looking at the longer-term transmission revenue path. Given the long timeframe, the following chart uses real prices (i.e. adjusts figures to remove inflation).



Assumptions

Demand growth (1.9% in 18/19 and then averages 1.1% in RCP3 & RCP4).

CPI (1.8% 18/19, 1.9% 19/20 at 2.0% to the end of RCP4) – this is used to discount to real \$.

There have been various references to a PwC diagram which purports to depict transmission as the leading contributor to residential price increases.² Vector used the PwC graphic in its submission to claim: “By contrast to all the other supply chain elements the increase in transmission charges has been the most significant”. Vector used the same PwC chart in its October 2018 submission to the Electricity Price Review, in that case including footnotes qualifying the underlying data.

The timeframe selected for the chart is short, from 2004 to 2017. The start date of 2004 was the low point for transmission charges following a sustained and well reported period of under-investment in transmission assets beginning in the early 1990s. It was also just prior to commencement of significant consequential reinvestment in the grid. Both trends are shown by the figure above.

The end date for the PwC chart (2017) coincides with the high point for transmission charges following this reinvestment. Accordingly, to select this timeframe for a chart outlining the makeup of consumer electricity charges is misleading.

In addition, the notes below the chart (omitted from Vector’s submission to the Commission) indicate the line titled Transmission also includes the cost of payments by distributors to embedded generators for Avoided Costs of Transmission – which is not a cost of transmission. Another note conveys that MBIE’s QSDEP data is the basis of the chart. We draw your attention to the technical notes for QSDEP, which we consider provide some clarity with respect to how QSDEP reports transmission costs:

¹ [Transpower, Securing our Energy Future 2020 – 2025 Regulatory Control Period 3, Draft Proposal for Consultation, August 2018, Appendix 3.](#)

² From the PwC report titled “Real price increase by component of total delivered electricity charges (excl. GST) for a domestic consumer using 8,000 kWh 2004 – 2017”.

“It is important to note that:

- 1) ***The transmission component is determined by lines companies and can include additional charges that are passed-through to consumers. In this situation, it does not reflect the actual cost of transmission.***
- 2) *The lines charges information is sourced for one particular tariff type in each lines area. Lines areas can have many different tariff types, with the composition and amount varying by market segment (households, industrial, etc.) and how electricity is being used.” (emphasis added)*

Te Mauri Hiko

We acknowledge and agree with the comments from Genesis about:

- (i) “the need to anticipate the considerable investment and resourcing that will be required to ensure the transmission system is ready to enable New Zealand’s transition to a low emissions economy”; and
- (ii) the need for the issues around the Te Mauri Hiko scenarios where electricity demand doubled by 2050 to be addressed outside the scope of Part 4 regulation, including “change to the National Policy Statement and broader resource consenting framework, including considering how transmission corridors could be more efficiently developed”.

Demand growth projections

Vector and MUEG raised concerns about Transpower’s demand growth projections. Both appear to have referenced the growth projections in Te Mauri Hiko.

For the avoidance of doubt, Transpower has not used the Te Mauri Hiko scenarios in our Asset Management Plan or our RCP3 proposal. The intention of Te Mauri Hiko is to help inform and prepare for the longer-term, with horizons that go beyond RCP3 or the Asset Management Plan.

Te Mauri Hiko has been useful in informing the work we need to do during RCP3 to prepare our business to respond, whichever scenario emerges for RCP4 and beyond. As we stated in our consultation paper on the draft proposal for RCP3:

“We consider our investment needs up to the mid-2020s, which are presented in this proposal (and in more detail in our 2018 Transmission Planning Report), will not be materially affected by Te Mauri Hiko projections, which forecast increased growth from 2030 onwards. We have started to work through the consequences of Te Mauri Hiko on longer-term system investment needs.”³

Different demand growth projections may be appropriate for different purposes. For example, Vector and Wellington Electricity have both undertaken scenario analysis of potential impacts of future technology, with the potential impact of Electric Vehicle uptake on EDB investment and capacity requirements.

Like Transpower with Te Mauri Hiko, Vector and Wellington Electricity have developed scenarios by thinking strategically to prepare for the future.

³ [Transpower, Securing our Energy Future 2020 – 2025 Regulatory Control Period 3, Draft Proposal for Consultation, August 2018, page 63](#)

Should Transpower contract directly with retailers?

Vector's suggestion Transpower should contract directly with retailers has parallels with the Electricity Authority's original (2012) transmission pricing proposals which would have enabled precisely that outcome. The Authority's subsequent proposals have not retained that idea.

A similar argument could be run by retailers who might prefer all distributors to contract directly with end users and so avoid exposure to bad-debt risks associated with (distribution and transmission) network charges.

The changes that would be needed to implement these arrangements sit within the Electricity Authority's jurisdiction, rather than the Commerce Commission or Part 4 Commerce Act. There would be transaction costs, the treatment of which would have to be resolved by the Commission.

Should there be a change to RAB indexing?

Vector also suggested Transpower's regulated asset base (RAB) should be subject to indexation in a similar way as for distributors' RAB. However, both approaches to RAB indexing are NPV equivalent and consistent with upfront financial capital maintenance.

Vector has previously argued the Commission should apply the Transpower RAB approach to distributors, including in its 2016 submissions to the IMs review. That review reconfirmed the approach to RAB indexing for Transpower.⁴ As such it is out of scope for the Commission's process of considering our RCP3 proposal.

We consider it is important for stakeholders to understand the role of the IMs, which is to improve regulatory certainty. By locking in key elements of price setting during formal IM reviews, Transpower, the Commission, investors and other stakeholders are provided with certainty on the rules and processes that apply to each regulatory reset.

Use of above normal returns to reward efficiency improvements

Some stakeholders see above normal returns as evidence the Commission has been overly generous in price setting. However, we note that incentive regulation provides commercial incentives for regulated suppliers to improve efficiency. If costs reduce below the levels the approved expenditure allowance, the reward is an above normal return.

The Commission doesn't need to make judgements about, whether, or the extent to which, regulated suppliers have improved efficiency. Transparency on achieved and planned efficiency improvements helps to give our stakeholders comfort that the regime is working. We consider our RCP3 proposal provides such transparency.

The Commission has explained:

"...one of the main mechanisms we have to incentivise expenditure efficiency is capping the price (or revenues) that EDBs can recover from consumers over a period (ie a 5-year revenue path, known as price-quality regulation, or PQR). In effect, this de-couples price from costs for a regulatory period.

PQR aligns the interests of EDBs and consumers – the revenue the firm is allowed over this period provides a target the supplier can outperform by becoming more efficient (ie EDBs can

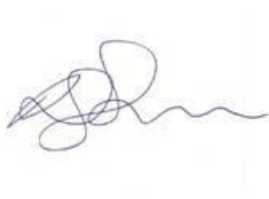
⁴ Commission 2015/16 IM review [Form of control and RAB indexation](#) and [Final decisions](#)

increase profits by reducing costs). These efficiencies are then passed back to consumers at the next reset in the form of reduced prices.”⁵

Closing remarks

Generally, we agree with Meridian’s view that “the Commission’s intended process, framework and approach for setting Transpower’s IPP is generally appropriate”. We look forward to hearing our stakeholders’ views on our proposal in 2019.

Your sincerely

A handwritten signature in blue ink, appearing to read 'Rebecca Osborne', is positioned above a faint, light blue rectangular stamp.

Rebecca Osborne
Regulatory Affairs & Pricing Manager

⁵ Commerce Commission, [Commerce Commission regulation of energy networks - key concepts](#), Prepared for IPAG, June 2018, paragraphs 28 and 29.