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14 June 2017

Keston Ruxton
Manager, EAD Regulation Development
Regulation Branch
Commerce Commission
P O Box 2351
Wellington 6140

By email: regulation.branch@comcom.govt.nz

Dear Keston,

RE: Transpower capex input methodology review – Proposed focus areas

Pioneer Energy Limited (Pioneer) appreciates the opportunity to make submissions on the Commerce Commission (Commission) proposed focus areas for its review of the Transpower Capital Expenditure Input Methodology.

Pioneer is a member of the Independent Electricity Generator Association and supports its submission.

Pioneer's primary interest is in the requirement for Transpower to consider transmission alternatives / non-transmission solutions as it develops its major capital expenditure programme. We commend Transpower for the long term strategic thinking in its *Transmission Tomorrow* and note the conclusion that the transmission grid will continue to be required but there is uncertainty about the capacity and investment needed over time.

We submit that Transpower should be required to consider transmission alternatives for both base capex and major capex investment.

Pioneer has a number of distributed generation development prospects which can be alternatives to investment in transmission infrastructure. The key issues relating to consideration of these generation prospects as alternatives to transmission investment are:

a) the scale of the generation plant investment compared with transmission investment, which is, by its very nature, likely to be a step change in capacity due to economies of scale;
b) the required rate of return on an investment by a third party relative to Transpower's regulated weighted average cost of capital; and
c) information asymmetry and the issues of a small player negotiating with Transpower.

These points are discussed below.

a) Difference in scale

Pioneer agrees with the Commission that transmission alternatives / non-transmission solutions[1] help avoid sunk costs that can't be recovered. We submit that Transpower should be required to consider transmission alternatives for both base capex and major capex investment.

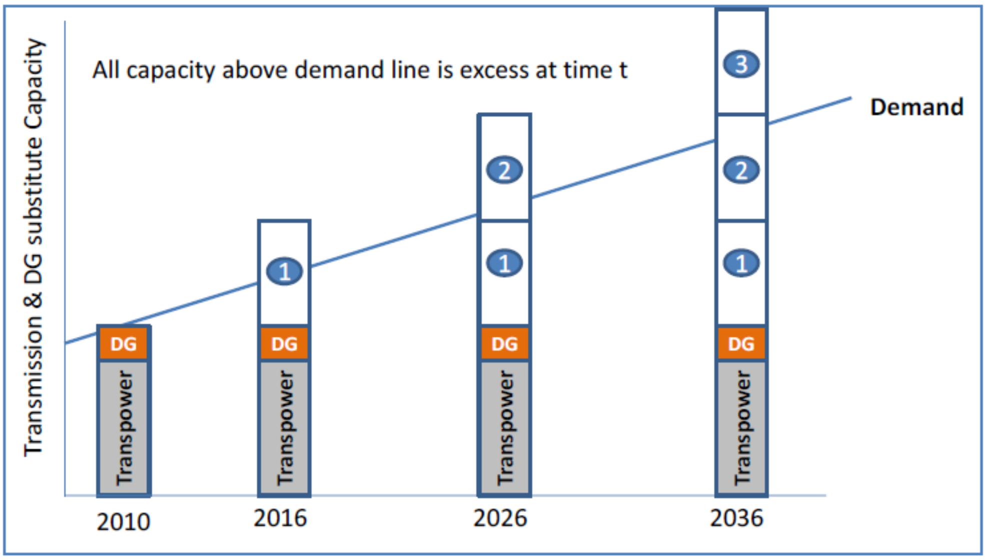
Pioneer has a generation option in the Upper South Island reliability project that could contribute to delaying the planned transmission investment for that region (at Orari). The process to review and approve transmission alternatives must accommodate the different scale of investment – our investment might be valued at about $5million compared with the full transmission project of around $50-60million.

We support a staged approach to infrastructure investment. A staged approach is more likely to result in no-regrets investment and better enable transmission alternatives to be a real option to meet an identified need but where there is uncertainty about how this need might develop over time.

It may be that deferral options can be derived from a portfolio of investments – similar to the approach of Transpower's Demand Response programme. Pioneer's knowledge of the capex IM is limited but are overall impression is that the process for identifying and approving transmission or non-transmission investment needs to be more flexible to account for uncertainty about the required future transmission capacity.

b) Required rate of return

Investors in transmission alternatives or non-transmission solutions need a long term agreement and payment. If a generation plant is constructed as an alternative to, and delays, transmission infrastructure investment that plant continues to exist and is an ongoing part of the transmission network – depicted in the diagram below. The theory of economic sizing means that the next investment in transmission infrastructure may well result in excess capacity but the existing capacity continues to be paid for, that is the Maximum Allowable Revenue must include payment to transmission alternatives.



[1] Our understanding is that the term 'transmission alternatives' is used in relation to Base capex and 'non-transmission solutions' in relation to Major Capex projects

Transpower is, obviously, going to value the option of investment in transmission infrastructure at its own weighted average cost of capital (WACC) – determined by the Commerce Commission. The level of this return takes into account Transpower is 'guaranteed' its revenue, is a monopoly and has some benefits from being state-owned. A third party trying to contract a transmission alternative solution to Transpower is very likely to have a higher WACC than Transpower. The third party is therefore at a disadvantage to Transpower's own investment – unless the contract with Transpower can provide a level of assurance for the third party that lowers the risk associated with funding that investment.

Transpower's Prudent Discount Agreement is an example of a process and resulting long term payment that arises from robust analysis. Grid Support Contracts are to be the arrangement for a transmission alternative / non-transmission solution. However, it is not clear at this time how this might work or payment be derived as no such contract has been signed.

c) Information asymmetry and negotiating balance

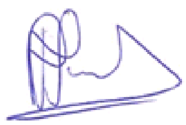
Pioneer appreciates the extensive information that is published by Transpower in its transmission planning reports and associated documents, as well as the consultation papers on major capex projects. However, Transpower is the expert in transmission planning and may have a bias towards investing in transmission infrastructure as that is where it's expertise and level of comfort sits.

Information asymmetry and difficulty dealing with monopoly network owners was identified as one of the reasons why the Electricity Governance (Connection of Distributed Generation) Regulations 2007 were put in place by government.

Pioneer agrees with the focus areas identified by the Commission. We suggest the Commission review whether the Capital Expenditure Input Methodology provides appropriate mechanisms for consideration and contracting of transmission alternatives and non-transmission solutions given the uncertain future Transpower has mapped out in its Transmission Tomorrow report.

Pioneer is engaging in regulatory processes by the Commerce Commission and Electricity Authority to ensure, where possible, low entry barriers, equal access to network information and a regulatory regime that is simple enough to understand and ensure innovation by small companies.

Yours sincerely



Fraser Jonker
Chief Executive