

[Commencing at 12 noon]

PRESENTATION BY TRANSPOWER (continued)

CHAIR: Well, good afternoon ladies and gentlemen; the appointed time having arisen, or having arrived, I think we might recommence.

Just before I ask Peter Taylor on my left to put a couple of questions, a very brief run-through in the latest revision of the timetable which we will circulate more fully.

We've got Transpower from now till 2.30, and then Todd Energy from 3.00 till 4.30; CC 93, 4.30 to 5.00 or thereabouts. Then tomorrow Transpower again at 1.00 o'clock and NZEM following Transpower, and then the applicant replying on Friday. So, it's been extended another day, but unless something completely untoward happens we should finish on Friday. So, we will circulate confirmation of that.

All right, I'll ask Peter Taylor I think who wants to kick off with a couple of questions from yesterday.

MR TAYLOR: Yes, thanks. I'm following up on a question that Ms Bates discussed with you, Mr Thomson, about investment in the grid and I just want to make sure that I understand correctly what you said.

It was to do with investment in grid security with the issue, and I understood you to say that, in your view, there had been no under-investment in grid security.

MR THOMSON: It's my opinion that there has been adequate investment to preserve the security of the power system, of the grid, but there has not been enough investment to probably get the optimum under-investment for a market for pricing, if you know what I mean. There's a big difference between the two. That's my opinion.

MR TAYLOR: It's the first bit I was concentrating on.

I wanted then to go on and ask, if there had been any ODV -- sorry.

MR THOMSON: I think you've got to tie that in to the Commission -- people having said we're far too tied to security. We have invested adequately for security, and that's all, and it's certainly not over-adequate, if you know what I mean, we've been tight.

MR TAYLOR: We understood that was your position yesterday, no question.

MR THOMSON: If we were very concerned about security with no relationship to cost, we would have invested more.

MR TAYLOR: No, I understood that.

I was coming at it from the other end actually, which was, has there been any investment which you would regard in that, "Adequate" definitions that has subsequently been written-off under the ODV approach? And you may not have that

Transpower (cont)

1 to hand, and if you can come back to us on it if you want to
2 just check it through?

3 **MR THOMSON:** We'll check it through. But look, my reaction is
4 that, if you go back -- oh, you know, 94 I suppose, there was
5 considerable ODV write-off, okay, right back. I think most of
6 that's been put back into the ODV. We'll go back and check;
7 we'll come back to you tomorrow.

8 **MR TAYLOR:** You understand where the thrust of where my question
9 was coming from?

10 **MR THOMSON:** I'll tell you what, there's been stuff-all ODV
11 write-off.

12 **MR ROBERTSON:** You mean, apart from the \$500 million?

13 **MR TAYLOR:** I realise that's small change to you chaps.

14 **MR CURTIN:** Just to understand your position, there's been no
15 write-offs other than the write-offs?

16 **MR THOMSON:** See, there's two lots of write-offs; there's write-
17 offs due to efficiency due to technological change that we
18 see, and then there's write-offs from over-build and bad
19 decisions, and I think they're different things.
20 Peter is in charge of valuation; what do you want to
21 say?

22 **MR ROBERTSON:** I see if we can get some specific information in
23 response to the question this afternoon.

24 **MR TAYLOR:** Just the point that you referred to with regard to
25 the asset base for pricing purposes. Is the asset base for
26 pricing purposes the same as your ODV value base?

27 **MR ROBERTSON:** Yes, it is.

28 **MR TAYLOR:** Okay, can you get back to us as to whether there has
29 been any ODV write-off in investment and adequate grid
30 security? That would be good.

31 **MR ROBERTSON:** You're talking significant, presumably? There's
32 stuff around the edges that drops out as a result of the
33 assumptions.

34 **MR TAYLOR:** No, no, serious stuff.

35 **MR THOMSON:** On some of the capital investments we've made we've
36 had a write-off immediately of say 20%, investments that are
37 really necessary that are not optimised out. You're talking
38 about optimised out investment, aren't you?

39 **MR TAYLOR:** I don't understand when you say "have an immediate
40 write-off of 20%". Are we getting a bit too detailed?

41 **MR ROBERTSON:** I think we should give you the specific answers to
42 that. I think what Mr Thomson's referring to -- the ODV has
43 defined building blocks and they assume a Greenfields
44 approach, for example, whereas the reality is, when you are
45 adding equipment at a substation it's not Greenfields at all,
46 and so, sometimes you incur costs in accommodating equipment
47 that you wouldn't incur were it to be a Greenfields site; just
48 as an example.

49 **MR TAYLOR:** I understand, we've had a bit of experience recently
50 with these issues.

Transpower (cont)

1 **MS BATES:** Can I follow up on that Mr Thomson because I'm quite
2 interested in your response to Mr Taylor, about saying there
3 was adequate investment to protect the security of the grid,
4 but not enough to get optimum investment for the market, and I
5 was just wondering whether you could elaborate on that a bit?

6 **MR THOMSON:** If I can take an example like the Central North
7 Island. The legislation was changed last year to allow us
8 to -- I've got to be very careful of the wording too -- to
9 carry out more maintenance in limited upgrades on transmission
10 lines, all right. As soon as that happened we removed a
11 triangle bottleneck in the middle of the North Island. We did
12 it last Christmas.

13 The reason for doing that was that, we -- well, I
14 became concerned, everybody else did too, that if we had very
15 high peak loads in Auckland over the summer and water
16 conditions on Huntly weren't too hot, we might get into
17 problems in the Auckland area with not being able to get
18 enough through.

19 Now, I think we allowed another 80 megawatts through the
20 ISMS by spending \$1 million pulling the lines tighter and
21 taking -- I think we took off a few hillsides to get bigger
22 clearances and, you know, we put a bulldozer through the -- we
23 shaved the top off the ridges so the wires could drop a bit
24 more; honest.

25 **CHAIR:** You're not talking about Mount Ruapehu?

26 **MR ROBERTSON:** It would be a poor season.

27 **MR THOMSON:** We did that so we could get more supply through if
28 it was a bad year in Auckland for the south. But there's
29 still a constraint left under certain circumstances and we
30 couldn't do enough in the short time, we had to get rid of
31 that constraint fully, because there's probably another 60 to
32 80 megawatts in those lines, with a lot more work. I don't
33 know how much money, probably 5 to 10 million bucks and we
34 didn't do that because we thought we were interfering in the
35 market. That was the reasoning.

36 **CHAIR:** All right, thank you very much.

37 **MS BATES:** Do you mean by that that you didn't consider it was
38 your job to do that?

39 **MR THOMSON:** No. Yeah, nobody would pay for it, all right. It
40 wasn't that much money, and -- well, nobody would pay for it.

41 **MS BATES:** Did you ask them?

42 **MR THOMSON:** Well, everybody's told us to remove constraints, but
43 nobody will pay for it generally. They know where the
44 constraints are. Do you want to add something Bill?

45 **MR HEAPS:** We are going to cover this issue under "new
46 investments". Particularly it concerns the issue you raised
47 regarding capacity and security.

48 **MS BATES:** Okay, I'll leave it until then.

49 **CHAIR:** Okay, thanks Mr Thomson. Ms Callinan, back to you
50 please.

Transpower (cont)

1 **MS CALLINAN:** Thank you Mr Chair. Just before we resume the
 2 submissions as written in the outline, there were, I believe,
 3 one or two questions regarding PJM that were left on the table
 4 last night too and Nicki Crauford will address those.

5 **DR CRAUFORD:** I think the question that I was asked was, whether
 6 Transpower had any views on having a PJM style of market,
 7 including governance -- was that correct, Commissioner Curtin?

8 **MR CURTIN:** Yes.

9 **DR CRAUFORD:** I'd like to answer that first of all by looking at
 10 what I see as the characterisation of the PJM market and then
 11 referring to whether that meets with the four objectives that
 12 Mr Thomson raised yesterday morning.

13 In PJM in my view there is a strong regulator with a
 14 clear idea as to what they see as the correct market design;
 15 indeed, FERC has even come out with a standard market design.

16 PJM has an independent board with a common good mandate,
 17 and then reporting to that board are a number of industry
 18 groups who are making recommendations to that board.

19 So, in relation to the requirements that -- the
 20 principles that Transpower believes are necessary for a
 21 successful governance arrangement, there is mandatory
 22 compliance. There is a means of ensuring consistency of rules
 23 across the wholesale physical market. The governance board
 24 can make executive decisions, and the equivalent of a guiding
 25 principle or a clear market design is there as well.

26 So, yes, it does have all the requirements that we would
 27 seek in a good governance arrangement.

28 **MR CURTIN:** Thank you very much.

29 **CHAIR:** Can I just ask you a follow-up question. Does that also
 30 mean that in addition to the market design, as you say the
 31 governance board, in your view a specific sector regulation in
 32 addition is a requirement? I mean, Professor Hogan was very
 33 strong on this regulator being there for the out-of-control
 34 event, if you like, and he talked about the California
 35 situation.

36 So, do you see also that standing alongside a governance
 37 structure, as you just described, there needs to be another
 38 regulator as well?

39 **DR CRAUFORD:** I don't think that's necessarily what we're saying.
 40 I think there needs to be some clear accountability and
 41 certainly that's not the case in the counterfactual when it
 42 appears to be the Minister who is taking that accountability.

43 **MS BATES:** Just to clarify with PJM, it's a governance board
 44 appointed by the State?

45 **DR CRAUFORD:** Appointed by the State, yes.

46 **MS BATES:** And what's its relationship with the Federal
 47 regulator?

48 **DR CRAUFORD:** It is appointed by -- sorry, it is appointed by the
 49 Federal State Regulator, FERC.

50 **MS BATES:** I see.

Transpower (cont)

1 **CHAIR:** If the governance structure was as you outlined it, then
 2 you wouldn't see the need for another regulator on top of
 3 that, that's my point?

4 **DR CRAUFORD:** I think it could be an option here, but I don't
 5 think it's necessarily a requirement in order to meet those
 6 four governance principles that we've outlined.

7 **CHAIR:** Because Professor Hogan seemed to be saying that was an
 8 additional requirement.

9 **DR CRAUFORD:** In his opinion, he thinks it would be a
 10 requirement. I don't think we're going quite that far.

11 **CHAIR:** Thank you very much.

12 **MS BATES:** It's just to clarify; the Federal Regulator's
 13 countrywide --

14 **DR CRAUFORD:** Yes, that's right.

15 **MS BATES:** Does it have any relationship with the State
 16 Government as far as the regulation of the governance board is
 17 concerned?

18 **DR CRAUFORD:** In PJM they are not regulated by the State,
 19 although not directly. They have a good relationship with the
 20 State Regulators and they keep them informed of what's going
 21 on, but I believe there is no direct control of PJM by the
 22 State Regulators. It is by the national regulator.

23 **MR THOMSON:** We could find out, but I'm pretty certain that FERC
 24 regulates transmission, certainly regulates interconnecting
 25 links, and there's a boundary between the State and the
 26 Federal. There's just been a big Federal Court case on it.

27 **MS BATES:** I don't think I need to pursue it any further, I just
 28 wanted to understand that bit there, thank you.

29 **MS CALLINAN:** I just thought it would be useful to start off with
 30 a very brief recap of where we have got to on Section 2 of the
 31 submission on the risk of pro-competitive rules being blocked.

32 In summary, Transpower says in the first instance that
 33 there are both incentives and opportunities by the vertically
 34 generated retailer to block pro-competitive rules under the
 35 arrangement -- this is not in the written submission, this is
 36 a short summary.

37 On that point the question of market power was raised,
 38 and we are preparing a paper on that with some more
 39 information about market power, and we propose to present that
 40 at the appropriate time tomorrow -- we'll come back to that
 41 issue.

42 The second point that we're seeking to make is that the
 43 experience from the NZEM should not give the Commission any
 44 come tort that pro-competitive rules will not be blocked.
 45 Pro-competitive rules have been blocked or delayed in the NZEM
 46 and financial transmission rights are an example. It leaves
 47 part of that -- at least part of that the delay was attributed
 48 to self-interested actions of the participants in attempting
 49 to take the rentals away from Transpower which would have
 50 prevented them being used to fund the FTRs.

Transpower (cont)

1 The second point is, when properly analysed the
2 applicant's figures on the NZEM rule changes demonstrate that
3 pro-competitive rules are more likely to be delayed than
4 relatively uncontroversial once.

5 The third point is, in Transpower's submission the
6 Rulebook will not improve on the position under the NZEMs
7 because the industry EGB manages the process but will not
8 determine the outcomes.

9 The counterfactual will be better, in Transpower's
10 submission, because of the direct involvement of the Crown EGB
11 which will have decision-making powers. The final limb to
12 this section of the submission is that the applicant has
13 submitted, contrary to Transpower, that Transpower will, under
14 the counterfactual, have both the incentive and the
15 opportunity to block pro-competitive rule changes.

16 Transpower has responded already to the specific
17 examples given by the applicant, when Nicki Crauford talked to
18 demand side participation and dealt with some details in the
19 appendices in one of the other rules. Alex Sundakov will now
20 explain why, in Transpower's submission, this position by the
21 applicant can't be sustained.

22 **DR SUNDAKOV:** Thank you. I'd like to relatively quickly respond
23 to this argument that came up in the second LECG report. The
24 argument essentially was that there's a risk of the Crown EGB
25 would itself strike-down pro-competitive rules and the
26 argument is in two parts.

27 The first part says that this would happen because
28 Transpower is particularly interested in system security, and
29 that wherever there is a conflict between system security and
30 pro-competitive diversity, it would choose system security
31 every time, and that therefore it will have an incentive to
32 push for rules that are anti-competitive.

33 The second leg of the argument is that Transpower would
34 dominate the Crown EGB. Essentially the applicant painted the
35 picture of the industry EGB as being a careful balance between
36 interests, where the interests of system security as expressed
37 by Transpower would be carefully balanced by the interests of
38 greater diversity and greater competition as expressed by
39 generator/retailers; while the Crown EGB was painted as being
40 more likely to be dominated by the state-owned transmission
41 provider.

42 What I'd like to do is respond to both legs of this
43 argument but start with the second one, and this is the
44 question of the likelihood that Transpower would dominate the
45 Crown EGB.

46 The LECG argument -- the key argument is that the
47 economic literature broadly says that concentrated interests
48 tend to favour well-resourced concentrated interests in
49 political processes. Transpower is an example of such a

Transpower (cont)

1 concentrated interest, a well-resourced interest, well-
2 connected to the political process.

3 Clearly the literature as a general proposition is
4 right, it describes the broad trend as observed
5 internationally, but I think we have to be careful here
6 because it's implausible to argue that Transpower is the only
7 concentrated interest in this process, and what the literature
8 also says is that when you do have a series of concentrated
9 interests, or a number of concentrated interests in the
10 political process, the outcome is indeterminate.

11 In this case it seems to me that the generator/retailers
12 also provide a highly resourced concentrated interest; the
13 majority of them are also state-owned and therefore also have
14 very good political connections. As we've seen from this
15 process, they are also very well resourced, able to bring in
16 the best available information and advice.

17 So, I think what we're likely to observe under both the
18 Crown EGB and the industry EGB is a series of relatively
19 concentrated well-resourced interests bringing their arguments
20 together, and it's not at all obvious which side of the
21 argument is likely to dominate. I think one has to be very
22 careful in interpreting this proposition that Transpower would
23 dominate the Crown EGB.

24 In fact, it seems that one could almost paint the
25 opposite picture that suggests that the Crown process is
26 likely to be a careful balance; a careful balance between two
27 competing concentrated interests, with the Government weighing
28 up the two interests. Whereas the industry EGB, it doesn't
29 actually balance the interest. The industry EGB operates on
30 the basis of voting allocation. In those circumstances, where
31 the voting allocation clearly favours one side, the outcome
32 will favour that side whichever way it goes.

33 So, I guess what I'm saying is that, just cautioning
34 that this sort of very simple characterisation of the industry
35 EGB as being a careful balance and the Crown EGB as being more
36 prone to capture, I think has to be dismissed and the reality
37 is much more complex.

38 I think it's also important to remember the industry EGB
39 is also essentially a political process. The distinction is
40 often made between commercial transaction based processes and
41 political processes and the commercial transaction based
42 processes is where you can transact with each other, there is
43 value exchanged and the value is what determines the
44 relationship.

45 A political process is where somebody can be compelled
46 by majority vote, and in that sense the industry process is
47 also a political process, and I think that the question of
48 who's going to dominate that, who is going to be able to bring
49 the best lobbying, the best resources into it, remains open

Transpower (cont)

1 given that there are a number of very powerful concentrated
2 interests there.

3 The next leg of the argument is that Transpower is over-
4 interested in system security, and I think this issue has
5 already been canvassed. It's clearly a matter of opinion, but
6 I guess what I'd like to do is raise a number of questions. I
7 think that essentially it's actually very difficult to say
8 whether Transpower is concerned about system security, it's
9 excessive from the national benefit point of view.

10 We do know and it's observable in the way the positions
11 have been taken, that Transpower is more interested in system
12 security than generator/retailers but that doesn't actually
13 tell us very much at all. It says that given the current
14 liability structure generator/retailers are likely to have an
15 incentive to take greater risks than their customers would.

16 The fact that Transpower is more interested in system
17 security than generator/retailers suggests they may be
18 somewhat closer to the customers, but it's hard to see from --
19 from that observation alone we can't tell whether they are
20 over-concerned about system security or whether their concern
21 is greater than the customer's concern. I think the real
22 question here, in terms of establishing where Transpower falls
23 in its attitude to system security, is how well does the
24 Transpower attitude to system security mirror the customer's
25 attitude.

26 **MS REBSTOCK:** Can I ask you a question here and I think you're at
27 risk here from being overly simplistic in the sense that,
28 customers may very well be concerned about system security,
29 undoubtedly they are, but they are also concerned about the
30 cost of electricity in the overall network.

31 So I think we need to talk about system security that is
32 provided in a cost-effective way that consumers value, and it
33 seems to me that you could look at the proposal as an attempt
34 to bring those two -- to bring some balance between those
35 interests. In other words, bring the benefit of Transpower's
36 concern and incentive to look after system security, but
37 balance that with the self-interest -- it may well be of the
38 other players to look after cost-effectiveness of the overall
39 network.

40 You could even argue that the Government's preference
41 for an industry-lead processes is because it believes that you
42 can get a better outcome if you bring balance; the balance of
43 the concern for cost-effectiveness with Transpower's incentive
44 to be concerned about security, and you can reach the right
45 sort of optimal outcome through that, and you could look back
46 in the history of this process and say that's exactly what has
47 led to the form we're sitting here and listening to.

48 So, I mean, I think that I would value your comments on
49 that. It is not impossible to contemplate a situation where,
50 even if it is self-interest on the part of the

Transpower (cont)

1 generator/retailers, or commercial interests, that the two
2 concerns couldn't actually be balanced reasonably well in an
3 industry forum.

4 **DR SUNDAKOV:** Thank you for stopping me from using loose
5 language. Certainly what I meant was cost-effective system
6 security. I think there are two issues again that you raise.

7 The first one is this question of balance, and I think
8 the point that I was trying to make right at the beginning is
9 that, if you are thinking about the balancing of the two
10 interests under the proposal, under the counterfactual, what
11 I'm saying is it's actually not plausible to argue that the
12 proposal is a much better way of balancing the two concerns
13 than the counterfactual.

14 The counterfactual is also likely to have a balance, it
15 just simply strikes me as being implausible to describe the
16 counterfactual as being where it will be completely captured
17 by Transpower, so you would also have a balance and it's not
18 at all obvious that one would balance any better than the
19 other.

20 The second point I was also trying to make is that, when
21 you are talking about balance, the question is, what are we
22 balancing? If you are balancing on one hand self-interest of
23 generator/retailers which may drive to under-investment in
24 system security, and on the other hand an attitude of system
25 security which is consistent with customers' preferences for
26 cost-effective system security, and if you fall somewhere in
27 the middle you are actually going to have under-investment in
28 system security.

29 For balancing to work you have to have pressure for
30 under-investment on one side and for over-investment on the
31 other side. I think what I'm saying is, again one has to be
32 very careful not to assume that Transpower necessarily is
33 pushing for over-investment. Yes, there's no doubt that it's
34 more interested in system security than generator/retailers,
35 but I think to assume that it's pushing beyond that, beyond
36 what is appropriate, it has to have a set of preferences that
37 relates to cost-effective system security that is
38 significantly different to what the customers would prefer.

39 I'm just -- you know, I think we don't know, I mean
40 obviously it's very difficult to establish what it is the
41 customers' prefer, what is it the Transpower's exact
42 preferences are. But I think it's not obvious at all that
43 they have had this kind of extreme concern over system
44 security that goes beyond what the customers would prefer.
45 Because, to go beyond what the customers prefer, in part, they
46 have to have a financial incentive to over-invest in system
47 security.

48 **MS REBSTOCK:** Do they? There are all kinds of incentives on
49 Government owned --

Transpower (cont)

1 **DR SUNDAKOV:** If we could identify a financial incentive to over-
2 invest in security, we'd say then they're more likely to have
3 more interest than the customers. And we know that financial
4 incentive doesn't exist under the statement of corporate
5 intent.

6 So, I think that the key point I would make is that,
7 when you are looking at this balancing point you have to be
8 very careful not to readily assume that you are balancing
9 under-concern with over-concern, and if you are balancing
10 under-concern with appropriate concern, you are going to have
11 a problem.

12 **MS REBSTOCK:** Can I come back to this point you made that they
13 don't have a financial incentive to over-invest.

14 Surely what incentives Transpower operates by don't have
15 to purely be the financial incentive. Can't it just be
16 because -- I mean, I know in your note you indicate that they
17 are going to have a greater incentive than other participants
18 to focus on system security. It may be the primary thing that
19 the Government holds them accountable for. So, for other than
20 financial reasons they may be incentivised; it doesn't have to
21 be a purely financial incentive, does it?

22 **DR SUNDAKOV:** That's absolutely right. But again, I think the
23 question is, would you expect the Government to hold them
24 accountable in a way that exceeds customers' preferences for
25 cost-effective system security.

26 **MS REBSTOCK:** I think it's somewhat more complex than that,
27 because I'm sure that part of the history of the various
28 committees that have tried to deal with these issues has been,
29 how do we know what customers value? Can customers make the
30 trade-offs? It isn't as simple, it seems to me, as just
31 saying I want this much security for X price because there are
32 different ways to achieve these differing levels of security,
33 and part of it is, how do you get the incentive on --
34 Transpower and other parties -- to find the least cost means
35 of providing for, not just security, but for electricity
36 generally. It may mean in some cases that you might do
37 something different when you look at the whole network; then
38 you would, if you were only optimising your transmission
39 investment in terms of security.

40 **DR SUNDAKOV:** I think it's absolutely right, and we'll come back
41 to that issue when we come to talk about new investment.
42 Because the choice is what is it you are doing in order to
43 achieve security whether you are concentrating on transmission
44 or not and how you go about doing it is very important, and
45 again I think we'll suggest that we don't really see a
46 fundamental difference there between the proposal in the
47 counterfactual in the way that that choice is likely to be
48 made. I think also --

49 **MR THOMSON:** Can I just add something? You cannot say that the
50 applicant's voting system that's in front of you has got the

Transpower (cont)

1 customers' represented to make their point of view in the
 2 voting structures. There's no way that they are represented,
 3 so how can you have any balance? Sorry; I mean, that has been
 4 the continual argument of the customers throughout EGEC, that
 5 they need more input, and they haven't got it.

6 **CHAIR:** I think that point's been made by a couple of speakers.
 7 The only point I'd make there of course, in leading up to
 8 votes there's obviously significant discussion.

9 Can I go back to Alex Sundakov. You comment on the
 10 applicant's view of Transpower's ability to influence, if you
 11 like, the outcomes of an EGB through Ministerial lobbying or
 12 whatever.

13 Would it be a fair question that, if you're concerned
 14 with security as against a generator who's there to sell
 15 electricity, all things being equal with the security hat on,
 16 wouldn't you have more credibility with the Minister in that
 17 context rather than somebody who's making electricity for
 18 sale?

19 **DR SUNDAKOV:** I think what Ministers are constantly trading off
 20 is exactly the question that's been asked, security at what
 21 price. Now, we know just from the fact that we don't have an
 22 exceptionally gold-plated transmission network, we know that
 23 the past political decision-makers didn't say, "just build,
 24 just give us absolute security regardless of price."

25 So, clearly Ministers aren't just concerned about
 26 security. If you are faced with an argument from Transpower
 27 saying, "look, this is what we need for security" and an
 28 argument from a determined well-informed group of
 29 generator/retailers saying, "no actually you don't and what's
 30 more it's going to result in high prices to consumers
 31 unnecessarily", the Minister is going to find it very
 32 difficult to make the decision. But the Minister isn't going
 33 to say, "I ignore everything and go for security."

34 **CHAIR:** Are you likely to get four generators taking the same
 35 view on these issues?

36 **DR SUNDAKOV:** Not all the time, not necessarily. But to the
 37 extent to the idea that's been expressed is that the industry
 38 process allows this balancing, then I think certainly it's
 39 envisaged as generators falling on one side and Transpower
 40 falling on another side.

41 **MS BATES:** I'd like to make the point, Mr Sundakov, that under
 42 the Crown EGB the consumers don't have any direct
 43 representation at all. They used to have some under the
 44 industry EGB.

45 **DR SUNDAKOV:** Absolutely.

46 **MS BATES:** In fact MEUG prefers, not this model, but prefers the
 47 industry model. So, it doesn't seem as if the consumers have
 48 great faith in the Crown EGB to necessarily represent their
 49 interests.

Transpower (cont)

1 **MR ROBERTSON:** Could I just ask a question. There seems to be a
 2 lot of presumptions about what the counterfactual actually
 3 says. It's not clear to me that the counterfactual says
 4 Transpower will only have the security interest. Where's that
 5 assumption come from?

6 **MS BATES:** No, but there's no direct consumer representation on
 7 the board by way of votes or anything like that.

8 **MR ROBERTSON:** But we're assuming that whatever representation
 9 there is takes -- it seems to me there's been a lot of
 10 discussion about representation taking the form of
 11 participation in working groups under the counterfactual, and
 12 I was really speaking more to the Chairman's point which
 13 seemed to presume to me that Transpower would have a sole role
 14 in advocating security, and I don't understand why --

15 **CHAIR:** I wasn't necessarily saying that. But certainly I was
 16 saying that Transpower would be concerned, understandably,
 17 with security which is obviously part of the company's brief.
 18 Is that likely to have more weight or more say with a Minister
 19 in the totality of the issues than say a generator's view on
 20 capacity of generation, if you like?

21 **MR ROBERTSON:** Not in my view, not if we were to presume under
 22 the counterfactual that Transpower, for example, continued to
 23 have the balanced objectives that we currently have. I think
 24 we would point to our track record to date which -- there
 25 seems to be a consensus that we haven't got over-investment,
 26 and I just don't see why we can make a step into another realm
 27 under the counterfactual.

28 **CHAIR:** I hear what you say. I'm just trying to tease out some
 29 of the comments the applicant made, that Alexander Sundakov
 30 has commented on and to get a view on that.

31 **DR SUNDAKOV:** If I could come back to your point. I think
 32 clearly there's no obvious consumer representation or
 33 necessarily any consumer representation on the Crown EGB, but
 34 I think that's precisely the board -- it's not a
 35 representative board, it's an independent board -- and it's
 36 weighing up a series of concerns both on the producers and
 37 consumer side, which the Government is going to reflect.

38 I think the difference I see is that, when it's weighing
 39 up these concerns against the concerns of the Government, it
 40 inevitably has to face, the Government in the role of the
 41 Minister is more likely to be worried about impacts on
 42 consumers -- given that's where the votes come from -- versus
 43 the industry EGB where a voting process comes out one way or
 44 another.

45 **CHAIR:** Could I just ask one question of Dr Crauford before
 46 Ms Callinan picks up again. You talked about the financial
 47 transmission rights, the FTRs and the fact that delays in
 48 introduction have been due to anti-competitive objectives on
 49 the part of those opposed.

Transpower (cont)

1 There's been some discussion about the nature of some of
 2 these products that have been offered. Would some of the
 3 elements of delay in that debate be in relation to the former
 4 FTR rather than their being seen as a competitive enhancing
 5 initiative?

6 **DR CRAUFORD:** Some of the discussion that has taken place has
 7 been about the form of the FTR and the design of the FTR, and
 8 one would expect that. Indeed, the consultation process,
 9 extensive consultation process that Transpower undertook was
 10 about some of those design options. So, yes, there has been
 11 some debate on that.

12 There was largely consensus on the crucial design issues
 13 though, with perhaps two exceptions; one was information
 14 disclosure and the other one was market power issues.

15 **CHAIR:** Okay. Thank you.

16 **DR SUNDAKOV:** If I just may finish with one final point in
 17 conclusion. When we're talking about system security, I think
 18 it's also important to -- in kind of in weighing up those
 19 concerns -- to remember that Transpower may be also quite
 20 interested in diversity, because diversity adds to security;
 21 so it's not necessarily there's an obvious point where
 22 Transpower has an incentive to drive for uniformity, as the
 23 LECG paper suggests.

24 But also the benefits of uniformity, the benefits of
 25 common standards for promoting competition shouldn't be
 26 dismissed because, when the standards differ, when there isn't
 27 a uniformity of standards, what you're likely to find -- and
 28 this comes back to I think LECG's point, that concentrated
 29 interests are likely to get a better hearing -- that where
 30 standards are not uniform the benefit of disparaging standards
 31 is likely to be captured by incumbents, and we'll come back to
 32 that issue when we discuss the transitional dispensations,
 33 which I think is a very good example of precisely that
 34 happening.

35 **MS CALLINAN:** What we propose to do now is -- on page 21 of the
 36 submission, 2.10(b), an example of combined cycle gas turbine
 37 generation, is just close off this discussion on the pro-
 38 competitive rules with a reference to the part of the LECG
 39 paper headed up "Decisions That Have Prevented Increased
 40 Competition". Under that heading they've given an example
 41 which applies that Transpower's frequency standard has
 42 prevented the introduction of CCGT generation in New Zealand,
 43 and Transpower's submission on this is that it is incorrect.
 44 Transpower has not prevented any CCGTs from connecting to the
 45 grid, and has instead specifically amended its common quality
 46 standards to enable the connection.

47 Mr Heaps will talk to this on behalf of Transpower.

48 **MR HEAPS:** I'd like to start off by talking about some of the
 49 characteristics of New Zealand, and then move on to the

Transpower (cont)

1 process that's been followed in changing the frequency
2 standards.

3 The under-frequency performance of the New Zealand
4 electricity system is unique due to the small size of the
5 country, and the small size of the system, and the relatively
6 large scale generation in HVDC. Just to put some figures on
7 that, the North Island peak demand is around about 4,000
8 megawatts. The minimum demand is just over 2,000 megawatts,
9 and if you think of the HVDC as 1,000 megawatts and the CCGT
10 is around about 300 to 400 megawatts, so that gives you an
11 idea of the figures in there.

12 Historically in New Zealand the grader has experienced
13 fluctuations in frequency, down as low as 45 Hertz. In the
14 1970s and the 1980s standard required generation to stay
15 connected down to a frequency of 45 Hertz for one minute, and
16 hydro electric and thermal generation was constructed and
17 designed to meet that standard.

18 **CHAIR:** What's the minimum frequency, say, for a large network
19 overseas? Say, in Australia? 47, 48, or what are we talking
20 about?

21 **MR THOMSON:** Should be 48. UK, USA, you don't get any
22 fluctuations generally; I mean, they're steady as a rock.
23 Australia, I think would be 48.

24 **CHAIR:** So there's quite a difference between there and here?

25 **MR THOMSON:** We could get those figures for you.

26 **CHAIR:** Just to get a comparison.

27 **MR THOMSON:** They're far steadier networks.

28 **MR HEAPS:** Because obviously in the UK the density of the network
29 and generation connected, just the inertia there, you know,
30 one generator can't influence the whole system. That's the
31 point we're making there with the comparison of sizes. In New
32 Zealand the HVDC and one of the CCGTs there's a significant
33 component, particularly at the minimum demand.

34 **MR THOMSON:** If you go back to the early 1980s when it was NZED,
35 they wouldn't put machines greater than 250 megawatts onto the
36 system because of the risk of drop-off. That's why Huntly was
37 at 250.

38 **CHAIR:** Oh, I see; thank you.

39 **MR HEAPS:** When proposals for the introduction of the CCGTs were
40 first made in the mid-90s it became apparent that it wasn't
41 economic for the CCGTs to be designed to meet the requirement
42 to stay connected at 45 Hertz for 1 minute.

43 After extensive discussions between Transpower and the
44 generators, Transpower developed an equivalent frequency
45 standard for the CCGTs that would make it possible for them to
46 be connected if they could be designed to have rapid increases
47 in output to enable the plant to reduce the rate of fall of
48 frequency, thereby buying time for other plant and load
49 shedding to improve the situation.

Transpower (cont)

1 This equivalent standard was introduced in the first
2 version of the grid operation security policy which was
3 published in 1997 and enabled CCGT plants at Stratford,
4 Southdown and Otahuhu to be connected to the grid.

5 Subsequently Transpower and other industry participants
6 have been working together on the frequency standards working
7 group which was convened on the Grid Security Committee, which
8 in December 2001 proposed changes to the frequency standards
9 to shed load at an earlier stage, when frequency reached 47
10 Hertz rather than requiring generation to stay connected.
11 Transpower has accepted the GSC recommendation and is
12 currently implementing it by amending the common quality
13 obligations.

14 The change to the 45 Hertz standard is now possible due
15 to the development of more sophisticated system modelling
16 tools like the real time management tool, a greater
17 understanding of the CCGT plant, and the use of the Grid
18 Security Committee processes to enable the demand side to make
19 the trade-off and agree to shed load at an earlier stage.

20 Transpower did explore various equivalent arrangements
21 such as the CCGT operator arranging to pay for the shedding of
22 load when the CCGTs were first introduced. The alternative
23 suggested by LECG of purchasing compensating reserves and on-
24 charging the CCGT operator the costs of the reserves has never
25 been a practical option.

26 **MR CURTIN:** Just one quick point while we're on the
27 practicalities of the system here. You mentioned a proposal
28 that the demand side, the load side, would shed earlier as one
29 response to the frequency.

30 What as a matter of practicality is the scope for the
31 demand side to adjust its take? What sort of arrangements can
32 the typical demand side participants make? How realistic is
33 that?

34 **MR HEAPS:** We have under-frequency relays, so the whole system is
35 automatic. So, we arrange the load that can be shed in
36 response to frequency with the line companies and the whole
37 system is automatic. So, other than the very large customers,
38 the individual consumers don't have an input.

39 **MR THOMSON:** It happens very quickly; you know, parts of a
40 second, and you've got to dynamically control it very quickly.

41 **MR CURTIN:** Okay, so you're talking there about an agreement
42 around those semi-automatic engineering arrangements; is that
43 right?

44 **MR HEAPS:** Yeah, fully automatic.

45 **MR CURTIN:** You can tell I'm not an engineer; all right.

46 **MR THOMSON:** It becomes very hard to make those sort of
47 arrangements if you haven't got both ends of your grid in the
48 arrangement identifying at the decision, that's why I say
49 everybody has to join because then you get everybody locked

Transpower (cont)

1 up, otherwise you get somebody holding out for money when
2 everybody else has agreed to do it.

3 **MS REBSTOCK:** This solution took, what, seven years to find?
4 This solution on this proposal with respect to the combined
5 cycle plants; took seven years?

6 **MR THOMSON:** No, the combined cycle plants were there and had a
7 solution earlier.

8 **MS REBSTOCK:** Right. But the discussions that led up to the
9 latest proposals began in the mid-90s. Is that right?

10 **MR HEAPS:** To find a solution for the CCGTs to be connected under
11 the New Zealand conditions has been evolving over time. The
12 point that we're making here is that we were very co-
13 operatively and in a lot of cases taking the lead to introduce
14 these CCGTs rather than as the applicant suggested that we
15 blocked that process.

16 **MR THOMSON:** If you don't think this is serious, exactly the same
17 problem as we envisaged with CCGTs happened in Malaysia and
18 they shut their power system down for a very considerable
19 time. The same thing happened in Perth.

20 **MS REBSTOCK:** I'm not suggesting that it's not a serious issue,
21 I'm just wondering why discussions go on for seven years
22 before we get to a solution.

23 **MR HEAPS:** I think it's that we're endeavouring to find better
24 solutions. So, we put a solution in place and we're looking
25 for improved solutions.

26 **CHAIR:** I'll answer a question which is in slightly a different
27 direction from my colleagues, but I will nevertheless.

28 The new CCGT plants at Southdown or Otahuhu, were they
29 in essence standing idle while these processes were finalised,
30 or were they able to hook in when they were ready to go, as it
31 were?

32 **MR HEAPS:** They were hooked in when they were ready to go. They
33 weren't standing idle because of this issue.

34 **MR THOMSON:** You would have found that the Stratford one, there
35 were two bidders for it, I think National Power and somebody
36 else, and National Power withdrew and the other bidder got it,
37 but it went in on time. We made certain the plants ran, all
38 right, and we put conditions around them to make them run,
39 okay.

40 **CHAIR:** The Southdown one, the turbine wouldn't work, it was
41 nothing to do with this, was it?

42 **MR THOMSON:** No, nothing to do with this.

43 **MR CURTIN:** Thank you for the explanation of the CCGT. We
44 understand where you're coming from there.

45 We had evidence early on in the piece from the wind
46 power people, and I appreciate you may not be briefed on that
47 particular issue, but from memory they seemed to be arguing
48 that getting wind power connected to the grid was a bit of an
49 uphill struggle.

Transpower (cont)

1 I just wonder if we could have your comment on their
2 feelings of frustration, if you like.

3 **MR THOMSON:** Do you want us to research that and come back
4 tomorrow?

5 **MR CURTIN:** I appreciate you are not immediately briefed on it.

6 **MR THOMSON:** It's got to be rule changes -- it's a transmission
7 price issue, it's also how you dispatch them, and there's a
8 fair bit in it. It's a problem all around the world.

9 **CHAIR:** I'll ask you again, if you are able to give us any more
10 information, we'll need it fairly early tomorrow so the
11 applicant has time to -- if the applicant wants to cover it in
12 his reply, that's all.

13 **MR THOMSON:** I'll write a few notes out tomorrow morning by say
14 10, 11 o'clock, right?

15 **MR CURTIN:** I'd appreciate it, it's just we've heard one side of
16 the argument thus far and it's helpful to get the other side.

17 **CHAIR:** Right, Ms Callinan again, please.

18 **MS CALLINAN:** I'd like to, at this stage, move on to Section 5 of
19 the submission, which is the risk of transmission under-
20 investment, and that's not to say that we won't come back to
21 say 3 or 4, but the questions are going in the direction of new
22 investment and we thought it might be helpful for the
23 Commission to address that sooner rather than later.

24 **CHAIR:** Yes, Donal Curtin has a number of questions on this, so
25 why don't you open the batting and we'll follow.

26 **MS CALLINAN:** Just to introduce the topic: At 5.4 we've really
27 summarised where Transpower sits on this. The main points
28 that we want to address is that voting coalitions will not
29 necessarily form sufficient investments in the way the
30 applicant has suggested and we'll talk to that.

31 The second key point Transpower makes in this section is
32 that under Part F rules there is no investor of last resort.
33 To the extent there is an appeal right to the industry EGB,
34 it's extremely limited. This is really the critical
35 difference that Transpower sees between the arrangement and
36 the counterfactual.

37 At this time I'd like to hand over to Alan Carvell who
38 will talk to this topic in more detail.

39 **MR CARVELL:** Thanks, Anne.

40 We're talking here about Part F of the Rulebook
41 primarily. That deals with transmission services and
42 substitutes for transmission services, and in particular we're
43 talking about Section 1 and Section 2 of Part F which deal
44 with investments as opposed to Section 3 which covers
45 transmission pricing methodology.

46 So, I propose to cover specifically Section 3, but if
47 there are any questions on that we'll soon pick those up.

48 I suppose it's worth noting that the Commission came to
49 the view that there was a potential for under-investment under
50 the proposal, and we certainly support that view.

Transpower (cont)

1 But at this point, just to pick up on the point Anne
2 made about our view of the proposal versus the counterfactual;
3 I'd like to run through that counterfactual quite briefly, but
4 to stress that our view is that the application of Part F
5 would be very similar under both the counterfactual and the
6 proposal.

7 The fundamental distinction being that we would expect,
8 under the counterfactual, that the ability to appeal to the
9 EGB on investment decisions would not be so narrowly defined.
10 The effect of that is that the counterfactual retains an
11 effective backstop or investor of last resort role. Our view
12 is that under the proposal there is no effective investor of
13 last resort role, and that is quite a significant difference.

14 **MS REBSTOCK:** Can you explain to us how that appeal right is
15 constrained under the proposal?

16 **MR CARVELL:** I will come on to that, if that's okay. It is
17 certainly part of this.

18 I think in part this investor of last resort role runs
19 to one of the comments that Commissioner Bates made yesterday,
20 that the industry may have a concern that it will be asked to
21 pay for a grid without having a say. I'm not sure where this
22 sentiment has arisen, but if that is an application to the
23 circumstance where we have a Crown EGB I guess there are two
24 points I'd like to make.

25 One is that the legislation, I think it's been canvassed
26 yesterday, requires the Crown EGB to consult and we believe it
27 would be inclined to fulfill the Part F Section 2 process to
28 fulfill that obligation to consult.

29 Secondly, we're talking here of a scenario where the
30 market has not, or the EGB might be in a position to believe
31 it's not expected to provide an adequate solution. So to the
32 extent that there might be a degree of compulsion, that is
33 exactly the compulsion which is anticipated in the Government
34 Policy Statement.

35 Two other points I'd like to cover on the
36 counterfactual, just to cover off some of the rationale for
37 why we believe that the counterfactual will be similar to the
38 proposal, i.e. It will adopt Part F, and in particular why it
39 would retain the voting processes. There are two reasons why
40 the voting processes would be retained.

41 The Government Policy Statement essentially provides for
42 a mechanism which will enable the industry to develop,
43 wherever possible or to determine wherever possible, solutions
44 which will benefit grid users; so it's making those decisions.
45 That has, I think, two benefits: One is this aspect of
46 consultation. So, if there is information out there in the
47 market that is able to be brought forward.

48 Secondly, when we're talking about solutions we're
49 clearly not talking about solely transmission solutions, and
50 so, the ability to have the decision-making processes in

Transpower (cont)

1 Part F, which will fulfill the requirements of Attachment 1 to
 2 the GPS, will also give opportunity to grid users to identify
 3 alternatives to transmission. And again, that's a requirement
 4 of the GPS at paragraph 16 of Attachment 1, talking about
 5 information being available, so grid users can identify
 6 opportunities for generation and demand side management and
 7 determine whether these are more appropriate than further
 8 investment in the grid by Transpower.

9 So I think the argument that the counterfactual will
 10 adhere quite closely to Part F principally is founded on the
 11 fact that we would expect the Crown EGB to comply with the
 12 GPS, and that's what the GPS requires.

13 The second part of this is, while we would suggest that
 14 in adopting Part F the Crown EGB would have a wider view of
 15 that appeal process. And again we refer to the GPS at
 16 paragraph 17 of Attachment 1, where there is no constraint, or
 17 no specific constraint on that access. The EGB is charged
 18 with, in addition to those circumstances where Transpower grid
 19 users are voluntarily agreed, ensuring that grid expansion
 20 takes place where the governance board are satisfied that the
 21 costs arising from firstly grid constraints and secondly
 22 security risks exceed the cost of relieving those constraints
 23 and risks through investment in the grid. An alternative
 24 response is, by industry participants or grid users, are not
 25 and are not likely to be adequate to resolve the issue. So
 26 again, this is how we would see the Crown EGB fulfilling its
 27 obligations under the GPS.

28 So, to do that it would need a wider -- there would need
 29 to be wider access to the EGB appeal process than is currently
 30 allowed under the Rules.

31 **MS BATES:** Just help me here a minute, with the counterfactual,
 32 because if the Minister has the decision-making power -- which
 33 it does under the legislation -- how can there be an appeal
 34 process which involves the EGB making the decision on the
 35 appeal?

36 **MR CARVELL:** I think it comes back to the discussions that we've
 37 had on a number of fronts in terms of who is making these
 38 decisions. I think we have to accept the legislation has the
 39 ultimate decision-making power resting with the Minister and
 40 that point's accepted. But the Minister makes those decisions
 41 on recommendations from the EGB.

42 So, I think we see the EGB in the counterfactual as
 43 being the body which pulls together the facts around
 44 investment process -- or an investment decision, in this case
 45 an appeal to an investment decision that's been made through
 46 an existing process specified in the rules and makes that
 47 recommendation ultimately to the Minister.

48 I think that is the role that the EGB will play; it will
 49 make a recommendation, but it does form the role of
 50 effectively assessing a particular situation in the context of

Transpower (cont)

1 costs and benefits. I think that comes back to the issue we
2 were talking about this morning in terms of security and cost-
3 efficient security.

4 Those assessments would be made. They would be made in
5 the environment where Transpower may have a particular view on
6 a situation and counter-parties would be posing their view.

7 **MS BATES:** This is all based on the assumption that the only way
8 the Crown EGB can really fulfill the Government Policy
9 Statement is by having a part in the process?

10 **MR CARVELL:** No, I wouldn't say "the only".

11 **MS BATES:** But you are putting that forward as being what's
12 likely to happen?

13 **MR CARVELL:** I think, as a general proposition, we've talked
14 about the Rulebook being adopted pretty much as it currently
15 stands. I think that the discussion here then centres on
16 where we would see those differences, and we're focusing now
17 on the difference in respect of Part F, which we would focus
18 on being primarily on this question of access to the backstop
19 or appeal right as being the matter that would need to be
20 changed in order to enable Part F to satisfy the requirements
21 of the GPS.

22 **CHAIR:** Because Part F is seen, I think, by the applicant as
23 being a significant step forward from current processes
24 anyway.

25 **MR CARVELL:** Interesting you observed that. My next area I
26 wanted to talk about was Transpower's view of Part F. Again I
27 wanted to clarify comments or questions that arose yesterday
28 from Commissioner Rebstock which certainly left me with the
29 impression that there was a view that Transpower may have some
30 significant reservations about Part F, at a general level we
31 were concerned. And, that's not the case.

32 We also see Part F as being a significant step forward.
33 In fact, I think we would characterise Part F as being really
34 one of the few areas where this process has made a significant
35 step forward, and in much of the rest of the process it has
36 sought to take what's already been in place and combine it
37 into one place or under one set of rules. There have been
38 some other consequences of that which we're not comfortable
39 with, but in respect of Part F, that is new; it is aimed at
40 addressing a number of concerns that both the industry and
41 Transpower have had with the investment process, and so, we
42 see it as a major step forward.

43 **CHAIR:** Because they are almost structural concerns, aren't they,
44 or concerns about current structures that the applicant has
45 evidenced, and you are agreeing basically in principle with
46 Part F?

47 **MR CARVELL:** Indeed. In fact, I'll come back to the point that
48 our concern with Part F is totally focused on the appeal to
49 the EGB for decision-making. I'll go on to explain why that
50 is, but clearly the two principal issues there are the

Transpower (cont)

1 potential for voting coalitions to form when we might
 2 objectively consider they should form, i.e. When on analysis
 3 that is a net beneficial outcome, and where that leads us in
 4 terms of a need for access to this backstop investor.

5 Just coming back to Transpower's view of Part F: At a
 6 general level we are supportive of Part F. We think it is a
 7 way of real progress from the Rulebook, but there are specific
 8 concerns and those resolve down to compliance with the GPS,
 9 and we think the constraints on appeal rights to the EGB fall
 10 short of compliance with the GPS. Executive decision-making,
 11 and again lack of ability to take an appeal to the EGB means
 12 that whilst in principle the EGB has an executive decision
 13 role under Part F, in practise that's most unlikely to ever be
 14 utilised.

15 The final comment I'd make in respect of Part F is one
 16 around comprehensive membership. It is a design assumption of
 17 Part F that membership is mandatory or the Rules are
 18 compulsory, whichever way you like to phrase that issue, and I
 19 think there are questions of participation in voting
 20 arrangements of those who are in or out of the Rulebook
 21 respectively and questions of enforcement which raise issues
 22 about the application of Section 2 in particular of Part F.

23 But again, if we come back to the four principal
 24 features that Mr Thomson outlined at the beginning,
 25 comprehensiveness or mandatory membership, executive decision-
 26 making and compliance aligned with the GPS, so three of those
 27 four. So we find those concerns as they manifest in respect
 28 of access to the backstop role are consistent with those
 29 principles in rectifying those concerns or rectifying our
 30 primary concerns with Part F.

31 **MS REBSTOCK:** First of all, I don't have a strong view on what
 32 Transpower's view is, but I'm trying to understand it.

33 You indicate that you see Part F as an advance, but if I
 34 understand you right, you think it's nevertheless going to
 35 result -- the result would be under-investment?

36 **MR CARVELL:** That's right. I'll come on and talk to the two key
 37 issues in the voting coalitions and what that then implies in
 38 terms of access to a backstop investor or decision-maker.

39 **CHAIR:** I might just ask Donal Curtin to raise a couple of issues
 40 which you may cover and move along.

41 **MR CURTIN:** I'd like to step back a bit to understand about how
 42 you go about the investing side of your business, first
 43 because I've asked a number of other submitters what their
 44 perception was of how much you invest and why. So I'd like to
 45 understand on behalf of everybody really, what are the
 46 investment criteria you use to identify worthwhile investments
 47 in your view?

48 **MR CARVELL:** If we could, I think it would be easier to answer
 49 that question in terms of some examples.

50 **MR CURTIN:** That was going to be my next question.

Transpower (cont)

1 **MR CARVELL:** I've got at least two other points to cover. Once
2 I've done that then we'll come on to Bill and he will run
3 through some examples to give a little bit more meaning to the
4 comments that I have in terms of our reservations.

5 So, fundamentally we believe Part F improves on the
6 status quo, it addresses a number of concerns we have in the
7 investment environment, so contracting and the like. I think
8 the conclusion we'd come to is the proposal overstates the
9 practical incentives on parties to form coalitions when
10 they're voting on investment proposals.

11 As I've said, the under-proposal, there's insufficient
12 access to this backstop or investor of last resort; which, in
13 effect, is a role that's necessary to compensate for these
14 realities of the market.

15 So, in terms of the voting coalitions, Part F improves
16 on the status quo in two key ways: It provides a decision-
17 making process or framework, the voting mechanism, and
18 transmission service is respecified, and the intent of that
19 exercise is to provide a more meaningful specification of
20 service. So, it has those two improvements to the
21 environment.

22 But you can't assume away the imperfection of the real
23 world. We can't necessarily believe that these will
24 disappear, and I think this comes back to the point that Alex
25 made yesterday in terms of needing to avoid caricatures and
26 assuming that the principles on which Part F is designed is
27 perfect flow of information, perfect agency etc and that these
28 things will indeed come to pass. Again, when we come to the
29 examples, we can explore those situations.

30 Transmission and indeed electricity as a product is
31 complex. Investment has been difficult in the grid. Where
32 we've talked about investing in security, effectively
33 Transpower stepped into that backstop investor role in the
34 past. We don't see that role existing in the proposal, and
35 that's at the bottom of our view that there will be under-
36 investment.

37 Investment is difficult, and contracting for investment
38 is difficult because of the interconnecting nature of the
39 system. Lots of potential for free-riding. It's also
40 difficult because the caricatures of Transpower being a
41 monopoly provider and a provider of what is effectively an
42 essential service.

43 So, these mean that there are significant externalities
44 involved in resolving investment decisions and those
45 externalities mean that the people who are making decisions
46 under a proposal may well not appreciate all the consequences,
47 costs and benefits that are faced by the ultimate consumers;
48 and again we raised yesterday I guess the degree of magnitude
49 of difference between the effect on consumers versus the cost
50 of revenue to suppliers for providing the service.

Transpower (cont)

1 So, there are quite large externalities and it's
2 questionable, in certainly my mind, as to whether those
3 externalities will be capable of being addressed through the
4 voting process.

5 It's difficult to define physical property rights, and
6 that means that there is the potential for hold-out. Again
7 the incentives to vote are going to be unclear. We can't
8 necessarily rely on theories such as agency to ensure that
9 what we might expect to happen in theory will actually be
10 effective in practise. The counter-parties that Transpower
11 are dealing with are generally monopoly lines businesses who
12 in effect pass transmission charges on, or vertically
13 integrated generator/retailers often operating in regional
14 monopolies.

15 So, I think there are real questions about the
16 incentives of the parties in those environments when they come
17 to vote.

18 So, it's by no means clear that in practise these voting
19 coalitions will form and will vote positively for a net
20 beneficial investment. If that's the case, then we need to
21 consider the role of the EGB as an investor of last resort.

22 So we're clearly anticipating under the proposal a need
23 to have recourse to the EGB through this appeal process.
24 Currently we would say Transpower fulfills that role and it
25 does that in respect of security risks. But Transpower won't
26 be in a position to fill that role under the proposal.

27 **MS REBSTOCK:** Can I just ask you a question. On this business
28 about Transpower being the investor of last resort currently
29 playing that role, and maybe I'll direct this question to
30 Mr Thomson, but how do you balance the need to do that with
31 the risk that you actually provide an incentive for the
32 parties to hold out, because they know that if they hold out
33 Transpower will step in and invest.

34 I mean, how do you...

35 **MR THOMSON:** Very good question, very difficult issue. You come
36 to head-on decisions at the last minute that you would make an
37 assessment that you can't go any further without the plant,
38 and at that point you have to invest, and that's exactly what
39 happens Commissioner; people sit and will not sign contracts
40 and you are forced into the position of putting it in, and
41 your mechanisms to overcome that are to go to local MPs and
42 local communities and say your area is at risk.

43 In other places, like Taupo, the customer decided not to
44 put a transformer in; gave it to us in writing they did not
45 want the transformer, didn't get put in. Then two subsequent
46 outages to the Taupo area as a result, and that's their
47 decision to take that lower standard of security.

48 **MS REBSTOCK:** But what I'm asking you -- I mean, I understand why
49 you in the end step in, so don't get me wrong; I'm just
50 saying, would it be so obvious that they could take that risk,

Transpower (cont)

1 that they would be willing to bear the risk, if you weren't
2 there as the backstop?

3 I mean, because it seems you could take the proposal as
4 trying to take that option away so that they do have to bear
5 the risk that they decide to wear.

6 **MR THOMSON:** I'd like Peter to come in, but I think the real
7 problem is, the liabilities -- it's like Alex has said -- the
8 liabilities are not properly defined on the customer side, but
9 for retailers or line companies or transmission to that
10 extent, and that doesn't give you the right signals for people
11 to make the decisions because they don't get it reflected
12 through onto them. It will take a long time to get those
13 liabilities right.

14 I mean, that's what all this Part F is about. I mean,
15 the liabilities are going to be defined for transmission
16 service -- it will take a lot of work, but it will get there,
17 and then you've got your contractual framework to put your new
18 investment on top of. I've got it right. I mean, that's
19 taken a year's work and the team working on it from the
20 industry, and lead by Brent Layton, has done a very good job.

21 I'd like to point out that I believe it's going to be
22 the same in both the counterfactual and the applicant's case;
23 I think it's work that's going to apply anyway.

24 So, I haven't answered your question, but I don't think
25 your idea of pushing will work because I don't think the
26 liabilities are properly defined.

27 Bill says it will come out in the examples.

28 **MS REBSTOCK:** But in terms of your experience on the various
29 working groups and that, has that been part of the thinking
30 behind the proposal, that it will shift the responsibility to
31 where it needs to go in order for the investment to be made?
32 I mean, is that...

33 **MR CARVELL:** I think the extent to which that view is reflected
34 in the proposal is that it was accepted in the transport
35 working group that access to the EGB appeal right shouldn't be
36 relatively easily attained, so there are obstacles to
37 overcome.

38 So for example, if an investment proposal is voted down,
39 you can't automatically go to the EGB on appeal, and in fact a
40 time delay was built in that said you had to put the proposal
41 for a second time and that that had to take place at least a
42 year after the first proposal. Some of the logic behind that
43 was to enable the market to get itself better informed if it
44 seemed to have failed the first time up at coming at a good
45 conclusion. So I think to some extent that proximity of the
46 investor of last resort was recognised and some obstacles have
47 made that more remote than it otherwise might be.

48 But then the question is do you take the next step and
49 say we shouldn't have one at all? I think Bob's answer in
50 terms of the significance of the externalities is the view

Transpower (cont)

1 that we would hold, that that in itself would have significant
2 consequences.

3 **CHAIR:** Yes, I mean just following on the Commissioner's
4 question; you don't think, if that last resort role wasn't
5 there, then the accountabilities are firmly in the hands of
6 the people that are going to suffer for it, and they may do
7 something about it?

8 **MR CARVELL:** I think the answer comes back to the externalities
9 issue, in that, the people who will suffer will be the end
10 consumers; well, they're not the people participating in this
11 decision-making process. So you've then got to put your faith
12 in some other processes to believe that their agents, in
13 effect, will act appropriately.

14 **CHAIR:** If I was Mighty River Power wanting to sell electricity
15 to people in Taupo, and if Transpower wasn't going to pay for
16 a transformer, I'd have to pay for it myself, surely. If you
17 weren't there, why wouldn't they have still come up with a
18 transformer?

19 **MR THOMSON:** I think, Chairman, the problem is, you're not
20 certain you're selling Mighty River's power to Taupo or Huntly
21 or Otahuhu or wherever; it all gets mixed up.

22 **CHAIR:** That's a fair point.

23 **MR CARVELL:** So, again that comes back to issues of property
24 rights.

25 **CHAIR:** It's a structural issue really that is independent of
26 whether Transpower is a lender of last resort or anybody else,
27 isn't it?

28 **MR THOMSON:** And the other thing, you know with that Taupo
29 example I gave you, what's actually happened is, I think the
30 thing's been sold twice since.

31 **CHAIR:** Transformer customers?

32 **MR THOMSON:** No, the lines network, and it all gets forgotten
33 along the way and the original guy won't recognise that he
34 made the decision to not put it in, and you get it all
35 confused; that's what actually happens, and then they all
36 start and come back and blame the central agency. I mean,
37 facts of life; get used to it.

38 **CHAIR:** I can see that. What I'm saying is, if you weren't there
39 then surely at the end of the day customers are going to
40 demand that lights stay on, surely?

41 **MR ROBERTSON:** But this isn't a question of whether we're there
42 or not, this is a question of whether you have one transformer
43 only or two transformers; in the event that one falls over,
44 power continues. So, this is a momentary -- this is a point
45 in time --

46 **CHAIR:** It's part of the automatic system, one compensates for
47 the other one?

48 **MR ROBERTSON:** Yes, so it's not as simple as a question of
49 whether we're there or not; we are there, but can our
50 transformer be knocked out for a period of time, and I don't

Transpower (cont)

1 think generators would be -- you know, the economics then
2 favour a call that says, well, we'll run that risk. The
3 parties who bear the real costs, the consumers, don't get an
4 adequate voice in this.

5 **MR HEAPS:** Can I make a point? I think the point that you raised
6 yesterday, Chairman, about the Bay of Plenty where you said it
7 was a transmission constraint, and what I replied, well, it
8 was actually fairly over-generation. In many circumstances it
9 could be seen as an increase in demand, and it could
10 definitely be seen as a lack of generation, but the
11 manifestation is that it is a transmission constraint.

12 You know, we're seeing this continually, that
13 transmission is being blamed as being inadequate, so
14 inevitably when there is a failure to make the investments, it
15 is manifested in a failure of transmission.

16 **CHAIR:** Well, an alleged failure of transmission. People say it
17 is; it may not be.

18 **MR HEAPS:** That's right, and so, ultimately the pressure comes
19 back on the transmission system and the transmission operator
20 to provide that.

21 **CHAIR:** I probably don't need to go on too long on this at all,
22 but provided there's a backstop there, I mean, I guess the one
23 that's arguing in a completely different area -- and
24 Mr Caygill will have some views on this -- but state
25 superannuation; while the state is providing X, is the
26 individual going to save? While you're providing a back-up
27 for transmission or a transformer, is anybody else going to do
28 it? That's the only question I'm asking.

29 **MR THOMSON:** Hey, practically, Mr Chairman, what has happened is,
30 a number of parties have come along with bypass options of the
31 grid to get our charging down, and we're very happy with that
32 if it's more efficient, and they've done it.

33 What happens is, something goes wrong with their bypass
34 option; it's not well engineered or it's not well thought out.
35 Practically, as soon as that happens, they come and blame the
36 transmission system and they put it back on the grid, when
37 what they have actually done is gone to try and cut their
38 costs and take higher risks. But they will not take the blame
39 for the risks, and there's no contractual mechanisms at the
40 end to pass it right through to the customer, and that's the
41 real problem.

42 If you had the outages charged for specifically, like,
43 the customer was paid if there was an outage for 10 minutes at
44 \$3.00 a kilowatt hour, or whatever it is, you would get all
45 the right incentives flowing back but there's nothing like
46 that.

47 So, I don't think it will work until you get all your
48 commercial tracks right through, and that's -- I'll be dead by
49 then.

Transpower (cont)

- 1 **CHAIR:** We probably both will but I think, looking at what
2 Mr Carvell said about Part F, it does seem that at least
3 there's an avenue that might have some outcome in this debate,
4 provided in your view it would need some changes, but that at
5 least is heading in the right direction, it would seem, from
6 what you are saying.
- 7 **DR SUNDAKOV:** Mr Chairman, can I come in for a second here
8 because I think it's important that the question of
9 backstop we're not comparing with the status quo where
10 Transpower has a backstop. Under both the proposal and the
11 counterfactual the backstop works in different ways and,
12 therefore, the incentives for hold-out are really pretty much
13 the same under the proposal and the counterfactual in the
14 sense that, when the backstop occurs when the decision goes
15 back to the EGB the costs are allocated on the basis of agreed
16 pricing methodologies, so by holding out you don't avoid the
17 cost be being allocated back to you. So, in that sense it's
18 quite a change.
- 19 **MS BATES:** Could I just clarify as well, so I'm absolutely sure I
20 understand this arrangement; you think the counterfactual
21 would involve Part F with the voting structure in place as it
22 is now?
- 23 **MR CARVELL:** We see no reason why it would change.
- 24 **MS BATES:** What about the consumer representation? Do you have
25 any view on that? I don't think they have votes under Part F,
26 do they?
- 27 **MR CARVELL:** Whether we're talking here about votes, we're
28 talking about the ability to vote on a new investment
29 proposal. So, I just draw that distinction between that
30 situation and a vote to change the Rules in Part F.
31 That's right, the consumers effectively rely on
32 representation of a retailer, or a generator, or a lines
33 business, or in some cases might be directly represented
34 because they are buying the service direct from Transpower.
- 35 **MS BATES:** But they don't have a straightforward vote?
- 36 **MR CARVELL:** That's right, your mums and dads at home don't get a
37 say in this, they are represented by other parties.
- 38 **MS BATES:** Do you think that's appropriate, do you?
- 39 **MR CARVELL:** Well, we think the difficulty under both the
40 proposal and the counterfactual is that it's not going to be a
41 practicable matter to be able to poll all the households on a
42 particular issue. So, you do end up with the situation that
43 you have to put some reliance on some aggregator for their
44 interests, and that might be a lines business, it might be a
45 retailer. Then you've got to ask the question, how reliable
46 is that aggregation going to be in representing those
47 interests.
- 48 **MS BATES:** So, the problem is, you don't think the consumers are
49 capable of having a body to represent their views?
- 50 **MR CARVELL:** I'm not quite --

Transpower (cont)

1 **MS BATES:** That's the flavour I'm getting from you, that the
2 difficulties of actually having the views of different sorts
3 of consumers represented would be insurmountable.

4 **MR CARVELL:** I think it's a question of, as I say, practicality
5 by and large, and contractual flow.

6 Transpower at the moment doesn't contract directly with
7 the household consumer. We contract with other parties, and
8 so, those other parties are the people who are engaged in the
9 negotiation, and we would then say well either on behalf of,
10 don't they, as agent. It's a bit like saying, we'll do away
11 with the wholesale market and the generators will sell
12 directly to every household.

13 **MR HEAPS:** Could I make a point because I recall this discussion
14 on the Transport Working Group as well, about who are the
15 customers, and really I think it comes down to who makes the
16 decision on new investment, and the whole of Part F is moving
17 the decision-making on new investment out closer to the
18 consumer.

19 But those that actually see those signals and can
20 evaluate the alternatives so the decision whether to invest in
21 new transmission or to build new generation doesn't
22 necessarily mean that the consumers are able to make those
23 trade-offs. So, it does tend to stop in the middle of the
24 supply chain at the retailers, lines companies and the
25 investors in generation. So I think that was the reason why
26 we didn't necessarily go to the point of having a referendum
27 for every new investment, despite the impracticality of doing
28 that.

29 **MS BATES:** I understand that. I understand what you are saying.

30 **MR CARVELL:** I've got a couple of points to follow and then I'll
31 pass over to Bill.

32 I'd certainly like to come back and just emphasise that,
33 whilst we have said here that currently Transpower fulfills
34 that backstop or investor of last resort role, our view is
35 that under the proposal, effectively no-one will because the
36 access to the EGB is so significantly constrained, and I'll
37 just come on and talk to that in a moment because I said I'll
38 point to the Rules in that regard.

39 Under the counterfactual we believe the EGB would fill
40 that backstop role. So we're not talking here about decision
41 rights that Transpower would retain in terms of the status
42 quo; we clearly see that those decision rights go elsewhere.

43 **MS BATES:** Just one more question, and I know you have explained
44 it, but I didn't quite catch it, and that is, why it is that
45 you think the Government Policy Statement so clearly supports
46 a Part F solution under a Crown EGB rather than the Crown EGB
47 simply consulting, as it is set up under legislation to do,
48 and forming its view on which it will make a recommendation to
49 the Government.

Transpower (cont)

1 Why does the industry have to have voting rights under a
2 Crown EGB model?

3 **MR CARVELL:** I think you could characterise a counterfactual
4 where indeed that was what happened; the Crown EGB consulted
5 to uncover this information. But by the same token, in terms
6 of adopting the Rulebook and looking at what needs to be
7 changed in order to comply with the GPS, it need not cast
8 aside sections 1 and sections 2 of Part F. It can retain
9 those.

10 **MS BATES:** But I think you made reference, and I'll ask you to
11 repeat it for the sake of clarity, to a particular part of the
12 GPS which I think you put forward as supporting the Part F
13 with voting rights being part of the counterfactual. I just
14 want to be definite about that.

15 **MR CARVELL:** Paragraph 15 of Attachment 1 of the GPS, it should
16 be left to industry participants wherever possible to make
17 decisions that benefit grid users. So, that's the first step.
18 You need some mechanism that would enable industry
19 participants wherever possible; so, if they can, let them. If
20 the processes don't come up with an appropriate result, then
21 intervene.

22 And paragraph 16 which then goes on to say that
23 information should be provided, effectively by Transpower, to
24 enable grid users to identify opportunities for generation and
25 demand side management and determine whether these are more
26 appropriate than further investment in the grid by Transpower.

27 So again, giving industry the opportunity to identify
28 alternatives to grid investment through that process.

29 **MS BATES:** One possible interpretation could be that's the
30 preferred route, that the Government has been quite clear, it
31 prefers an industry EGB to a Crown EGB. But the Crown EGB
32 might be, as has been put forward, the backstop if this
33 doesn't work.

34 **MR ROBERTSON:** I think we pointed also to experience
35 internationally with the range of decisions that are having to
36 be made by regulators; common practice is to use working
37 groups.

38 **MS BATES:** But this is not just working groups, this is voting
39 rights, and that's a different problem.

40 **MR CARVELL:** Can I explore the last comment you made?

41 **MS BATES:** I must say I'm trying to do this so I understand it.

42 **MR CARVELL:** I understand, I understand you have got a role to
43 challenge as well. I accept that.

44 But what I understood you were suggesting was that the
45 way this may play out is that the Crown intervention on
46 legislation would in fact be the backstop.

47 **MS BATES:** Yes.

48 **MR CARVELL:** I guess that comes back to some comments that were
49 made yesterday in terms of, when we might expect the
50 Government to actually unleash its nuclear weapon and failure

Transpower (cont)

1 to invest on one issue, is that going to be sufficient to pull
 2 the trigger on that or push the button, whatever the analogy
 3 is for nuclear weapons.

4 So, that would be my response; I'm not sure that that
 5 would have provided an effective mechanism, because it would,
 6 in essence, be the nuclear deterrent. So everything else
 7 might be going swimmingly in terms of industry self-
 8 regulation, but because the particular investment doesn't take
 9 place, does the Government pull the trigger on its legislative
 10 alternative?

11 **MS BATES:** Possibly, because it's a significant aspect we're
 12 talking about.

13 **MR CARVELL:** And possibly if it was a particularly significant
 14 investment I might agree with that.

15 **DR SUNDAKOV:** If I might come in for a second, because we had
 16 this discussion before and it may be worth clarifying.

17 Voting under Part F is essentially a substitute for a
 18 multilateral contract. You wouldn't want the Government to
 19 step in every time that Transpower can contract with an
 20 individual customer. Voting under Part F is simply an
 21 extension of that to allow for multilateral contracting, and
 22 the appeal right is the situation where you deal with the
 23 problem of externalities. So, if the multilateral contracting
 24 doesn't work then the appeal right comes in. But to the
 25 extent that the GPS says "hey, it's for you guys to make
 26 commercial deals to begin with", that's why we think voting is
 27 likely to stay in, because it's simply another form of
 28 contracting. It's different to voting to change rules.
 29 Voting under Part F plays quite a different role; it's a
 30 commercial contracting voting process.

31 **MS BATES:** Thank you.

32 **MR CARVELL:** I've got one more area I wanted to cover; this is
 33 the last. I mentioned earlier on about property rights and
 34 noted that the applicant in their material talk about FTRs
 35 designed to solve the problem of externalities, and as Nicki
 36 discussed yesterday, provide a financial right equivalent to a
 37 physical property right in effect.

38 I think the response to that is that, well FTRs go some
 39 way, they're not the perfect or complete answer here. They
 40 particularly will not necessarily be effective when there are
 41 large externalities and that's the sort of situation we
 42 discussed, and Nicki may choose to add to that or correct
 43 that, but that's certainly how I understand this issue in
 44 respect of FTRs, that even FTRs will not necessarily be
 45 affected when there are significant externalities and these
 46 are the sorts of environments we're talking about. So, with
 47 that I'll pass over to Bill for some practical examples.

48 **MR HEAPS:** Before I move on to the first example I'd like to put
 49 that in context and in doing so answer three of the questions
 50 which have come up. One is about Transpower's current policy

Transpower (cont)

1 on investment, and then the issue about capacity and security,
2 and then move on to, well, has there been under-investment.

3 First of all, just looking at capacity and security, I
4 think the observation that was made yesterday that under-
5 investment can be viewed from capacity and security
6 perspectives is a very valid one. However, both of those,
7 capacity and security, are linked because if investments
8 aren't made in capacity, then inevitably over time they become
9 a security issue.

10 Capacity shortages are generally seen as higher nodal
11 prices, that's how the market operates, and that's seen in
12 regions where constraints occur.

13 Transpower invests in line with market design and in
14 line with our statement of corporate intent, and that is when
15 we are contracted to make those investments. So, for capacity
16 as nodal prices increase in regions, we will make investments
17 when we are contracted to do so. Participants therefore have
18 to make the investment decision, not Transpower.

19 It would appear that, in some cases, they haven't made
20 the decisions, and that's through the evidence and submissions
21 that have been made and the anecdotal calls for Transpower to
22 step in and invest under those circumstances. A very strong
23 example of that is the central North Island constraint, where
24 over some years now there have been calls for Transpower to
25 invest because of high prices being seen in the upper North
26 Island.

27 Once security, once capacity hasn't been invested --
28 hadn't invested to improve capacity because participants
29 haven't made that decision, then over time that becomes a
30 security issue and security becomes threatened.

31 When security becomes threatened Transpower steps in
32 currently and invests, and we believe that under-investment
33 here has not occurred. But in certain circumstances, and
34 again the central North Island is a good example, we've
35 actually made much more efficient investments as Mr Thomson
36 described. Rather than building new transmission lines, we've
37 been trying to make the existing system more efficient and
38 squeezing capacity out of those lines.

39 One concern that we do have is that, if investments
40 aren't made for capacity, so there isn't a response to the
41 marketplace to signals, then there could be a backlog, so a
42 sort of wall of wood coming towards us, and inevitably that
43 could hit us at one time. Therefore when we have to step in
44 and invest for security, this could happen all at one time and
45 would stretch Transpower's resources.

46 So, there is a concern that if under-investment isn't
47 being made in capacity, that inevitably we will have to step
48 in and do those investments and the security and that this may
49 happen rapidly.

Transpower (cont)

1 So I think that hopefully covers those three questions
2 of current policy, the difference between capacity and
3 security, but the link there, and also under-investment at the
4 current time.

5 **MR CURTIN:** Okay, I'd like to follow-up on this and just by way
6 of context, in the Draft Determination there were a couple of
7 line items of reasonable size related to over-investment or
8 under-investment issues; I'm just trying to get a fix on that.

9 Plus last week you mentioned the wall of wood and there
10 was also a line of debate that suggested that potentially
11 there's some very large investment opportunities that the
12 economy is missing for some reason or other related to getting
13 the electricity to would-be investors which potentially is
14 another large number you could put into the calculations as an
15 improvement or a loss that we're suffering by not being able
16 to bank. So that's where I'm coming from.

17 I understand your explanation that investments happen in
18 capacity when you are contracted to. I wonder if you could
19 just flesh out a little bit what the value of new investment
20 in recent years has been in terms of either the contracted
21 investment or then in the security issue your own investment
22 to stabilise security?

23 **MR THOMSON:** We spent -- the capital budget in year on -- oh
24 boy -- capital budget on Transpower this year is 85 uh-huh.
25 I've got to take administration investment out of that. We'd
26 be running at \$70 million capital investment on the grid.
27 Now, when I come to split that between service change and
28 service integrity, integrity being security and service change
29 being customers, I've got to look up the figures.

30 [**pause**]. Peter, 20 million max, so there's be about 40
31 to 50 million on integrity, on security.

32 **MR CURTIN:** Thank you, and that's on an asset base of the best
33 part of 2 billion.

34 **MR THOMSON:** Yeah, 2 billion. Now, the capital charge is
35 misleading because we use infrastructure -- transmission lines
36 get continually upgraded, they are like an action, you put a
37 handle on one year and five years later you put the head on
38 and that's what happens to transmission lines. There's a lot
39 of stuff that's classed as maintenance which is -- and we're
40 very careful with it -- it is really enhancing the life of
41 your assets, and it's all governed by the handbook.

42 **MR CURTIN:** I think we've seen somewhere reference to the fact
43 that you're required to produce some kind of statement of
44 investment plans or statement of investment opportunities.
45 How does that fit into the whole framework?

46 **MR ROBERTSON:** For some years we prepared what's been called an
47 asset management plan and in -- I think we've now -- we've
48 supplemented that additionally over the last couple of years
49 with a statement of system adequacy -- sorry, system security
50 forecast -- the document's here -- [**indicates**].

Transpower (cont)

1 The general proposals contemplate -- and I think these
2 were first identified in the inquiry report -- that Transpower
3 should produce a statement of investment -- sorry, a system
4 security forecast, a statement of investment opportunities and
5 an asset management plan or a service delivery plan.

6 Conceptually the system security forecast or statement
7 of systematic, the same thing, is intended conceptually to
8 identify, based on what we know of the current status of the
9 grid, current committed plans for generation and forecast
10 changes in load, together with some forecast, I believe, of
11 uptake of new technologies such as distributed generation. It
12 is meant to identify effectively the hot spots on the grid
13 from system operation perspective.

14 The statement of investment opportunities is really
15 meant to draw a finer focus on those hot spots, and identify
16 the opportunities for investment from either a transmission
17 point of view ,or a demand side point of view, or a generation
18 perspective.

19 The statement of service delivery plan, is Transpower's
20 response to that. In other words, that's a statement from
21 Transpower saying, as the owner of these transmission assets
22 this is what we could do in order to satisfy those issues.

23 So, I've jumped into what is contemplated for the
24 future. Currently what Transpower does is produce the system
25 security forecast and follow that with an asset management
26 plan, which is effectively our response to what we see as the
27 hot spots. So that's produced, there is some dialogue with
28 the industry over that. I don't know what I could run so far
29 as to say that's what you would call consultation; there's
30 certainly interaction through our account executives with
31 customers in both preparing it and then considering the
32 consequences of it, but that fundamentally sets out the
33 operating policies -- from a policy point of view it sets out
34 our policy framework, principle policy performance objectives,
35 and there's intended to be -- the attempt is made to flow
36 through that document what we perceive we need to do by way of
37 expenditure on the grid to satisfy those principal performance
38 objectives.

39 **MR CURTIN:** We've heard quite a lot of debate or evidence that
40 there are all these desirable investment opportunities that
41 people can't contract for, or it doesn't get off the ground
42 for one reason or another.

43 Would you have any, in however ballpark , figure of what
44 the grid might look like if these desirable opportunities, on
45 which there currently isn't agreement, were to proceed?

46 **MR HEAPS:** I think the central North Island constraint is a good
47 example because several proposals have been put forward in
48 recent years on what we could do to relieve that constraint,
49 from extending the HVDC to Auckland to rather less sort of
50 elaborate solutions. So HVDC to Auckland would be,

Transpower (cont)

1 800 million, when in fact more generation in Auckland would
 2 probably be a better economic solution. There are proposals
 3 now to build more generation in Auckland.

4 **MR THOMSON:** Say if Huntly proceeds with a CCGT, which they are a
 5 long way advanced with, the restraint in the middle of the
 6 North Island goes. We have Otahuhu, Southdown and Huntly, as
 7 well as Mighty River Power all to the north; there is plenty
 8 of diversity in the generation side.

9 **MR CURTIN:** I understand that there are non-transmission
 10 solutions to some of these things, but in an ideal world if
 11 you are looking down and saying the best thing to do would be
 12 some transmission here and some generation there and you sat
 13 down and looked at it, what would the transmission grid look
 14 like if something like that were to be unlocked?

15 **MR ROBERTSON:** Is your focus on the recent past or looking
 16 forward?

17 **MR CURTIN:** Your choice, you tell us.

18 **MR ROBERTSON:** I'll answer; this is draft stuff, so please treat
 19 it in that way, but our analysis looking forward 18 years, in
 20 other words, to the year 2020, taking into account what we
 21 guess is the growth in demand, what we estimate to be a likely
 22 uptake of new technology in the form of distributed
 23 generation, making some allowance for new technologies, even
 24 for example allowing for fuel storage devices, our conclusion
 25 is that in order to meet that demand some new line routes
 26 would be required at the 220 KV level.

27 Given the difficulties of accessing new line routes, a
 28 preliminary conclusion is that we would be better to upgrade
 29 existing line routes from 220 KV to 320 KV and that would
 30 solve the capacity problem. The logic then of that conclusion
 31 would see us moving progressively towards outfitting the grid
 32 to be able to sustain that upgrade so that we would do that
 33 progressively over the ensuing period.

34 **MR CURTIN:** A very rough idea of what scale in terms of dollars
 35 would a project of that involve -- and I appreciate this is
 36 rather conjectural, but we are trying to --

37 **MR ROBERTSON:** Lots. I can come back with that information.

38 **MR CURTIN:** It's just that Part F, I think everyone's agreed, or
 39 something heading towards Part F has the capacity to unblock
 40 things, and if we're trying to get our minds around what's the
 41 value of a solution like that, we've got to have some guidance
 42 as to what's at stake here. Is it a dollar, is it \$1 million?

43 **MR ROBERTSON:** My guess would be -- if you are talking -- well,
 44 well in excess of 500 million if you are talking about the
 45 costs of getting to that 2020 solution.

46 **MR CURTIN:** Over quite a long timeframe?

47 **MR ROBERTSON:** Yes. I will ponder that when we adjourn, and I'll
 48 certainly come back with another view of that.

49 **MS REBSTOCK:** But your view is that, if Part F unlocks it, it's
 50 going to unlock it under the proposal or the counterfactual?

Transpower (cont)

1 **MR ROBERTSON:** That's correct.

2 **MR THOMSON:** A lot of that work -- they have just been overseas,
3 done it for the last six months -- a lot of that work is
4 because of technological change in the transmission areas. We
5 couldn't have done it -- his thinking wouldn't have been the
6 same three or four years ago, just wouldn't have been there,
7 the costs would have been a lot higher. The costs of
8 transmission and everything is coming down.

9 **MR CURTIN:** Appreciate that.

10 Professor Hogan I think when he was here commented quite
11 nicely about the ethos of the engineers, I suppose, or almost
12 the public service ethos of engineers when they're looking at
13 investments, and I think some comments of your own would
14 suggest you have that kind of line of thinking yourselves, and
15 that's fine.

16 I suppose thinking about that and some comments you've
17 got about the service delivery plan where you're required to
18 look at non-transmission solutions rather than spend
19 yourselves. I suppose I'm still trying to get a feel for
20 understanding the dynamics of what happens. If you folks are
21 looking at transmission only solutions or exactly how you make
22 that trade-off between transmission and something else or
23 something else.

24 **MR THOMSON:** There's a major investment -- there's a problem in
25 Auckland, if you look long-term, across the Auckland district,
26 it's a very difficult area. We're about to enter a
27 confidentiality agreement with one generator and we'll use the
28 sort of thing that's in Part F, whether it's approved or not,
29 to try and get a generator north of Auckland to put the major
30 investment out.

31 I can only speak about the track record over the last
32 eight years. If you look at the New Zealand electricity
33 system, the amount of 50 megawatt and cogen plants that have
34 gone in in the central North Island and in the North Island
35 where there's gas, it's quite big. I think it's gone from 1%
36 to 8% and that relieves transmission, and it's more
37 beneficial.

38 And everywhere where an investment decision is made,
39 that's taken into account; can you get the generation
40 investment in locally. I mean, you talk to CEOs and say, you
41 know, like, there's a problem into the Bay of Plenty, well,
42 for heaven's sake can you get a decent sized cogen plant
43 somewhere on the pulp plants, and of course they're
44 investigating that. It's kept confidential, because they're
45 all competing, and you are very careful how you treat it, but
46 that sort of thing goes on. It's national benefit.

47 **MR CURTIN:** Let me just come to the national benefit because
48 that's what I think we're all trying to get a handle around.

49 Supposing there's two proposals, one of which requires
50 you to spend \$1 and a generator to spend \$1; and the other

Transpower (cont)

1 proposal is, you spend nothing and the generator spends the \$2
2 or even spends \$3. How do you pick between those?

3 Supposing the dollar from you, the dollar from the
4 generator is one project, and \$3 from the generator is the
5 other project. The least cost to the economy is for the pair
6 of you to both reach into your pockets.

7 Can you convince me that you don't say to them, you
8 spend the \$3?

9 **MR ROBERTSON:** Well, I don't know whether I can convince you or
10 not.

11 **MR CURTIN:** I'm fairly gullible.

12 **MR ROBERTSON:** Try this: We have spent -- over a long number of
13 years now we have become, shall we say, experienced in working
14 with the concepts of the optimised deprivation valuation
15 methodology, and to some extent the original form of the
16 Rulebook which is published by MED represented a codification
17 of practices that we'd developed internally, and the origin of
18 that methodology -- as you are probably well aware -- was as a
19 result of recommendations to the Transpower Establishment
20 Board.

21 So that, we've worked with that for a long time and that
22 does involve, to quite an exhaustive extent, consideration of
23 the economics of investment both from the point of view of new
24 investment but also from the point of view of challenging the
25 value of existing assets. I suppose my thesis here is that
26 the skills within Transpower have developed over time that it
27 almost now becomes something of a background culture that we
28 consider a broad range of issues when we're looking at
29 proposals for investment.

30 One of the tests we have is whether or not there's an
31 economically preferable alternative. Now, the piece I'm not
32 answering for you is, whether we've become -- underlying your
33 question was, whether or not we've become so risk averse that
34 we would prefer to see anyone else make the investment rather
35 than ourselves.

36 I guess my response to that is to repeat a point I think
37 I made yesterday, which is, there is a culture inside
38 Transpower which is driven by seeking efficient outcomes.
39 We've gone to some lengths and endured some criticism over
40 some time for the strength of the views we hold on a number of
41 issues and those views are deeply held and stem from that view
42 of our role in the national efficiency equation. So I
43 wouldn't think that we would shirk a responsibility to invest
44 purely to avoid some sort of write-off in the future.

45 **MR THOMSON:** Could I add something else to Peter? The Chairman
46 queried me yesterday about commercialisation values in
47 Transpower versus public good, right. We are definitely not a
48 profit maximiser. It's been made very clear to us by
49 shareholder -- and that's right at the top and we've had
50 serious debate inside, like Peter's talked about, with Nicki's

Transpower (cont)

1 GM strategic services, and we clearly come down that we're a
 2 value enhancer for the industry. It's because we're
 3 Government owned and we make our rate of return, but we do not
 4 try and build assets just to build up the revenue stream;
 5 that's not the right answer.

6 **MR CURTIN:** I understand that. I think I understand how the ODV
 7 works. Let me rephrase it a little bit.

8 Along come a couple of projects, they both -- if you
 9 invest it, they meet your WACC, they stand up 100% on an ODV
 10 calculation, you'd be happy to take them on subject to the
 11 ODV; that's cool. But still, a range of these things come
 12 along, some requiring you to spend a bit more, some requiring
 13 the generator to spend a bit more; maybe sometimes the
 14 generator could fund that completely; there is no transmission
 15 investment required, but that mightn't be the joint least cost
 16 solution for the two of you.

17 I'm still trying to get -- I hear the point that you
 18 don't want to be doing sub-optimal write-off in ODV terms,
 19 investments, got that. That will still leave a range of
 20 potential investments that might very well meet the ODV test
 21 but still have a range of possibilities that the other chap
 22 does it, you do it, or the two of you together do it at least
 23 cost, and I'm just still not totally clear on how often that
 24 least cost solution is the one that's reached for.

25 **MR ROBERTSON:** I'm not sure I can -- well, someone else can have
 26 a try. I'm not sure I can give you the sort of answer you're
 27 looking for.

28 What we can say is that in large examples we do -- we
 29 are engaged -- the practice has seen us engaged heavily in
 30 consultation with customers, the Auckland project which Bill
 31 will speak to is a good example of that where -- I think Bill
 32 or Alan, someone mentioned earlier, that there were -- I'm
 33 thinking about this morning -- cancel that. You will hear
 34 about that. But there was something like nine or ten
 35 technology options that were worked up as a result of the
 36 technical working groups that came together to consider the
 37 options for Auckland.

38 The conclusion was to work towards a transmission
 39 solution. I think I described yesterday that our view is
 40 that, begin the lead times involved in that, we would still
 41 hold the view that the least regrets approach is a sensible
 42 way forward on that where we have some time to secure the
 43 options to build the transmission solution, but also to allow
 44 other technology options to emerge. I don't know that I can
 45 offer much more to your question.

46 **MR CURTIN:** Thank you for that. If we can change focus slightly,
 47 I think again --

48 **MR ROBERTSON:** I just wanted to make sure we had --

49 **MS REBSTOCK:** I did understand that it was qualified by the
 50 voting structure in the investor of last resort.

Transpower (cont)

1 **MR ROBERTSON:** That must have been eye contact.

2 **MS REBSTOCK:** I knew -- I asked the question because I thought I
3 would get a different answer, and it didn't come, but I did
4 understand what your position was.

5 **MR ROBERTSON:** Okay, so I don't need to.

6 **MS REBSTOCK:** You can go over it if you want, but I think I
7 pretty much knew what it was.

8 **MR CURTIN:** I think we've heard from Professor Hogan
9 particularly, but also from a lot of other people that this
10 issue of transmission investment crops up everywhere in
11 electricity networks and it's not necessarily specific to New
12 Zealand circumstances. We've had a whole range of factors put
13 in front of us, the interconnectedness of everything, free-
14 riding and ODV prices, none prices, all sorts of reasons why
15 this happens.

16 I'd just like to get your position on, if you are
17 identifying the obstacles to investment, would you care to
18 prioritise them -- or if you are trying to say, well, the
19 thing to clear most out of the way first would be this, and
20 then that, and then the other; or is there any hierarchy or
21 categorisation or prioritisation of the obstacles in the way
22 of investment?

23 **MR HEAPS:** Well, initially -- on a bilateral basis, so if
24 Transpower had an investment to make which affected a single
25 customer, then generally they are the simplest. So, we can do
26 a bilateral contract.

27 In terms of whether the customer will contract or not,
28 we have examples where that becomes difficult, even on
29 bilateral contracts, where customers hold out and hold out and
30 hold out and use Transpower as an investor of last resort, and
31 they don't have to take any of the risk on in a bilateral
32 contract; that's their perception, but they are generally the
33 simplest. And, of the service change contracts that we
34 mentioned earlier, they're the ones that the customer has
35 initiated; they tend to be all bilaterals. In fact, a
36 multilateral one doesn't come to mind.

37 So then you move on to the multilateral where there's an
38 investment to be made either in the core network or where more
39 than one customer shares the benefits of that. They have been
40 the ones that have been difficult to establish.

41 If I could just move on to the example that I'm going to
42 use, which is the experience we've had in Auckland, because I
43 think this will demonstrate that.

44 Between 1995 and 1996 Transpower developed a plan of
45 which had about ten alternatives for the long-term future
46 security of power supply in Auckland.

47 In 1997 we pulled together a working group, and that was
48 the power companies at that time because that was pre the
49 split of retail, so the power companies there are vector
50 united networks, north power and top energy. Under an

Transpower (cont)

1 independent Chairman, so we recognised some of the issues
 2 there and we pulled together under an independent Chairman,
 3 that's Doug Hefernan(?), who's Chief Executive of Mighty River
 4 Power, but he was an independent, and there are three main
 5 issues that the working group had to solve. One of them you
 6 might recall just before the CBD outage, I'm sure you will
 7 recall this Chairman, there was a voltage support issue in
 8 Auckland where we had to contract with a local power station
 9 there, at a very high price to provide voltage support because
 10 of a significant amount of air conditioning load that had been
 11 connected in Auckland, and that lead to some immediate
 12 problems that we had at the time.

13 The second issue that they had to cover were what we
 14 call the short-term investment projects, so these were
 15 projects that Auckland needed to have investments in over a
 16 period of one to five years. The third component was the
 17 long-term future, the 10, 12, 15 year view.

18 **CHAIR:** I'll just have to stop you there because our transcriber
 19 would just like five minutes I think, so you've just set the
 20 scene for the working group, what you're trying to do, and
 21 we'll start just after 10 past so the transcriber can have a
 22 break.

23
 24 **Adjournment taken from 2.03 pm to 2.10 pm**

25
 26 **CHAIR:** All right, we'll reconvene and Mr Heaps is just about to
 27 move into the Auckland issue in relation to the constraints
 28 and looking at solving them.

29 I'd like to draw it to a close around about 2.30 but I
 30 think it's important that we finish the particular issue
 31 you're talking about. Mr Heaps, please.

32 **MR HEAPS:** Just recall that there were three issues that were
 33 formed under an independent Chairman working group to resolve,
 34 one was voltage support, which did get resolved; the other was
 35 the short-term investment projects, and the other was the
 36 longer term investments projects.

37 On the short-term investments projects, agreement was
 38 reached on the technical solutions. So agreement was reached
 39 specific as, this transformer needed to be upgraded, a second
 40 transformer needed to be going, these switches needed
 41 reconfiguration. So, very detailed agreement on what was
 42 needed in terms of the investment was reached.

43 We then moved on to the commercial issues of who is
 44 going to pay, who is going to share the costs of the
 45 investment, and also, who would contract with Transpower, and
 46 over several weeks we failed to reach agreement. In the final
 47 meeting the power companies laid it on the table that they
 48 would not contract with Transpower, so we failed to reach that
 49 commercial agreement. The investments became more and more
 50 urgent and in the end Transpower did step in as the investor

Transpower (cont)

1 of last resort and we made those investments actually without
2 contracts.

3 On the long-term investment projects; we've now moved
4 into what we call the power links project, so we've developed
5 the power links project to fully assess the solutions that
6 were put forward earlier and come up with potentially new
7 solutions for Auckland's power supply out -- what, the next
8 15, 20 years. Those projects -- now the agency on those are,
9 we would need to have invested -- to maintain the minus 1
10 security level in Auckland we would need to make significant
11 investments by 2012.

12 We would need to be actually constructing, carrying on
13 construction, starting the construction in 2007, and to enable
14 that to happen consent applications and access would have to
15 be started in 2003. So, that project is now urgent if
16 security of supply is to be maintained in Auckland. So we
17 developed the power links project.

18 Again, technical solutions have come forward and again
19 there is some agreement, although there still has to be some
20 detail worked out on what the optimal route is and the full
21 technical details. However, the stumbling block again is
22 around the commercial issues. Who is going to pay and how
23 should this project, which is significant, hundreds of
24 millions of dollars, be paid for?

25 So that's the situation we're in today and the question
26 is how would both of those, the short-term projects and the
27 long-term project be dealt with under Part F. We believe that
28 the short-term projects, we would still face the same problem;
29 that a coalition potentially would not form, it would be
30 difficult to form for those projects, and if it wasn't, who
31 would step in?

32 Previously under the current situation Transpower
33 stepped in to make those investments, but who would step in
34 under the proposed arrangements? If nobody stepped in, then
35 we would have to attempt to use the appeal process which we
36 believe is inadequate.

37 On the long-term projects these are significant amounts
38 of money, up to \$300 million. Under Part F there is the
39 potential for Transpower to contract with retailers or others
40 for new investments because they're the ones that see the
41 signals.

42 Retailers in their nature are short-term -- they could
43 be short-term businesses in that area, the customer basis
44 could change, so they could be quite volatile. Whether they
45 could join coalitions to sign up for a 25 year contract would,
46 we think, would be extremely difficult to see.

47 Therefore we believe that for a significant project like
48 the Auckland upgrade, the power links project, the coalitions
49 are likely not to form and say please charge us 300 million
50 and, therefore, then we would have to move into the appeal

Transpower (cont)

1 process. Again we believe that the appeal process is
 2 inadequate to enable us to step in and have the EGB make the
 3 executive decision to go ahead with the investment.

4 **MS REBSTOCK:** Can you tell us what it is that's inadequate about
 5 the appeal process?

6 **MR CARVELL:** I actually had intended to come back to that in my
 7 discussion and I omitted to do so.

8 In particular, the ability to appeal to the EGB on
 9 investment decision is strange in two ways. One way is, that
 10 under rule 4.1.2 of Section 2 of Part F the proposal needs to
 11 have been put twice and a year has to have elapsed and so as I
 12 mentioned before we don't have a problem with. We think the
 13 appeal has to go through some hurdles so it's not an immediate
 14 default course.

15 But rule 4.1.2 of Section 2 of Part F does cause us
 16 concerns and that is a result which limits the ability to
 17 appeal to the EGB to situations where at least 25% of the
 18 votes of the transmission purchases to whom the resolution was
 19 put were held by distributors who have not adopted
 20 distribution service change procedures contained in the model
 21 distribution contract published by the board, or who do not
 22 use this process in the specified case or, if they did use the
 23 process in the specific case, they are distributors for whom
 24 the process is not usual practice in investment decisions.

25 We find that that narrows the situation in which you
 26 would be able to take an appeal down to such an extent that
 27 the appeal is, in effect, not going to be used. So, we would
 28 fundamentally like to see that rule struck out.

29 **MS BATES:** Can I ask you this. What you have described is the
 30 short-term and the long-term situation. It seems to me under
 31 both of those you are saying you won't be able to reach a
 32 proper decision and you will have to go and use the appeal
 33 process.

34 **MR HEAPS:** Our experience is that we have found it very difficult
 35 to form those coalitions.

36 **MS BATES:** Well then I just really can't understand, I'm having
 37 difficulty at the moment understanding why you would prefer a
 38 voting rights system with an appeal process over the Crown EGB
 39 simply making the decision after consulting with the industry
 40 and balancing the competing interests.

41 **MR HEAPS:** The reason is, in certain circumstances, in some
 42 examples we believe that those efficient decision-making
 43 processes could actually take place, which is why we've
 44 supported Part F and have said we believe that it is an
 45 improvement.

46 **CHAIR:** I think you are saying where the accountabilities or
 47 benefits are diffuse, then the question of financial
 48 responsibility becomes equally diffuse.

49 **MR HEAPS:** And perhaps where the investments are large.

Transpower (cont)

1 **MR CURTIN:** Again exploring why the coalitions don't form at a
2 commercial level and there are a number of competing
3 explanations that have been put to us. One is the fair shares
4 and the free-riding category of explanations, and another one
5 is around market power of people who may or may not have
6 benefitted from existing constraints, they might not be too
7 pushed to have them relieved, I think that's the gist of
8 what's been suggested. I suppose the last one is, Transpower
9 will do it anyway if we all sit around long enough.

10 Are all of those involved or would you lean towards any
11 of those explanations as the typical one?

12 **MR HEAPS:** I think all of them have got to be considered and
13 probably are elements for different types of participants as
14 well. I think I mentioned the one where a retailer may not
15 feel that he can sign a long-term 25 year contract because of
16 the volatility of their customer base, or of the business.
17 So, I think there are several reasons why incentives are there
18 for the coalitions not to form.

19 I think one of the other reasons that we've experienced
20 in the past, and would probably experience, is that again if
21 those investments aren't made the manifestation of the under-
22 investment is a failure of transmission. So I think, whilst
23 there may not be in the rules the ability for Transpower --
24 because the Rules take away the ability of Transpower to step
25 in as the investor of last resort -- whilst that isn't there,
26 there may well be a belief that, because the transmission
27 system would be seen as failing, that there is a likelihood
28 that that would happen and Transpower would have to step in
29 and invest without the contract.

30 **MR CURTIN:** Just coming back to another example that was put to
31 us by MEUG and some of the big generators last week, and that
32 was the case of the wall of wood, the major projects that
33 might lie around the corner.

34 The gist of those was, they didn't seem to be terribly
35 multilateral negotiations who might have a large Japanese
36 forest product factory somewhere and a line to them and a
37 generator -- oversimplifying, I'm sure -- but even in a
38 relatively compact -- what looks like relatively compact,
39 relatively isolated but major project, the argument was that
40 none of that was happening, and the argument I think was
41 partly laid at your door, that we just can't tell Jukken Nishu
42 or someone that, yeah, we can reliably give you 20 years long-
43 term supply. Supposedly here a willing buyer and willing
44 seller of electricity, but the missing transmission link.

45 So, I think you were bagged on this; what's your
46 contribution to it? Whether these typical projects are
47 languishing for lack of transmission and, if so, why?

48 **MR HEAPS:** I think I could add more, like Dargaville and Gisborne
49 in the East Coast, certainly the Southland area is another one
50 that's coming up. The West Coast, since they got their

Transpower (cont)

1 \$125 million for not logging the native timber, that they now
 2 want to invest there in other industries; electricity
 3 transmission may be an inhibitor. In the Southland area, they
 4 say that several industries would want to move there and
 5 create more employment in that area. However, there is a lack
 6 of electricity transmission.

7 Of course, any area can claim that, and several do. The
 8 nature of any investment in transmission to look to create
 9 more employment or incentive for businesses to join there, is
 10 speculative. It is as speculative as building a gold mine on
 11 the West Coast.

12 Now, Transpower has not made speculative investments,
 13 that isn't the nature of the business and I don't think it
 14 would be under Part F or under the counterfactual. The reason
 15 for Part F and for the nodal pricing system is to signal where
 16 new investments are needed where capacity is short, and then
 17 the market -- the participants in the market make that
 18 decision.

19 So, if more transmission investment is needed, say in
 20 the Southland area, then those who are going to benefit from
 21 that investment would actually be asked to sign a contract to
 22 pay for it.

23 **MR CARVELL:** Could I just make a comment here. I think I
 24 certainly agree with the comments Bill's just made in terms of
 25 concluding that, in this situation we would seek to have a
 26 contract, but it does seem to me from the way you described
 27 the scenario, the desire for a contract wouldn't necessarily
 28 be an issue, but the inference is that Transpower simply being
 29 unwilling or not forthcoming.

30 Correct me if I'm wrong, in fact this comment arose --
 31 or at least the instance in which I heard this comment, was in
 32 respect of the submission from Meridian where they were
 33 commenting on the issues arising under the proposal. So, it's
 34 not an issue of status quo analysis, but analysis under the
 35 proposal, and their concern that Part F had issues for
 36 bilateral contracts. So, that would be an issue that would
 37 exist potentially under the proposal and the counterfactual
 38 but is not necessarily relevant to an analysis of status quo.

39 **MR CURTIN:** I must admit, that's not my recollection, and we can
 40 both stand to be corrected by the transcript, but I can't
 41 remember whether it was Meridian or Contact, I have a vague
 42 memory --

43 **MR TAYLOR:** It was Dr Turner.

44 **MR CURTIN:** Okay, Meridian -- did have the flavour of investors
 45 actually coming down here, having a look, you know, some
 46 degree of preparatory sod turning going on, and I think the
 47 inference and possibly the outright statement was that there
 48 was, you know, some issue that you're in that prevented them
 49 coming to a commercial deal.

Transpower (cont)

1 **MR THOMSON:** Could I comment? We've always said, if somebody
2 wants to pay for it, we will do it; the contract will be done.
3 There's not very many people that will give you a 20 or a 25
4 year long contract. If you get a shorter contract, you've got
5 to put your payback over a shorter time and your cost of
6 transmission will become quite high and it forces in on-site
7 generation. Honest; that's what happens.

8 If you go from a 20 year pay back timeframe to an 8 year
9 pay back timeframe, most companies are very reluctant -- if
10 you have got 25 year long contracts like we've got with
11 Comalco, you've got very solid contracts, and most people do
12 not, you know, don't like riding a long-term contract because
13 there's big liabilities involved.

14 **MR CURTIN:** Okay, absent your point Mr Carvell, the new Rulebook
15 might interfere with the terms of bilateral contracts; are you
16 saying that from your end, you have no particular
17 philosophical problem with writing Comalco style contracts for
18 new forestry investors?

19 **MR ROBERTSON:** I think the question is what the contract would be
20 written for. I mean, we've been talking about a contract
21 where there were specific assets being constructed to connect
22 this new industrial plant to the grid perhaps, and that's
23 never been an issue as Bill highlighted. Typically that has
24 been the easiest area to resolve, where we have bilateral
25 discussions able to be had.

26 I'm not sure that it came out -- I've heard some of this
27 discussion previously -- not in the forum of the
28 Commerce Commission hearing -- and it correlates to
29 perceptions of unpredictability of the charging for sunk cost
30 recovery in respect of the core grid. If it did relate to
31 that, then the solution it seems to me under both the proposal
32 and the counterfactual is for an approved pricing methodology
33 worked through under the processes outlined in Part F
34 Section 3.

35 **CHAIR:** That last point is probably going to be fairly important
36 in either the counterfactual or the application. The pricing
37 principles have been put up by a number of people as well.

38 **MR HEAPS:** I should make it clear as well, you said would we be
39 willing to sign a Comalco style contract. We'd be willing to
40 sign a contract, not a Comalco style contract.

41 **MR CURTIN:** I meant it very generically.

42 Two to finish off. I think just one question on when
43 you are required to make your investor of last resort
44 investments. I think you indicated that -- Mr Thomson
45 indicated that you're quite uncomfortable with that in some
46 sense interfering with the market, that you are doing
47 something that people perhaps wouldn't pay for.

48 I just want to understand where you're coming from
49 there. I can see one line of argument where you are giving
50 basically an arbitrary subsidy to somebody. But was that your

Transpower (cont)

1 thinking when you were talking about interfering with the
2 market?

3 **MR HEAPS:** A good example, I think Mr Thomson was talking about
4 where we invested in the central North Island to relieve
5 security problems in the upper North Island during the summer.

6 What occurred then was that, as soon as we moved to
7 invest where there is a transmission constraint, inevitably
8 the constraint just moves; we end up chasing the constraint,
9 because generators are just the bids and offers to, in some
10 circumstances, recreate constraints and various things happen.

11 In the example of the central North Island constraint,
12 where we made the investments we needed to for security, we
13 had to draw a line and that line was the investments we needed
14 for security. The constraint actually did move and that's one
15 of the reasons why there's the problem with the Bay of Plenty
16 at the present time.

17 **MR CURTIN:** So your thinking -- just explaining your thinking
18 it's just, one solution like that arbitrarily redistributes
19 stuff all over the place; you're not necessarily taking
20 cognisance of somebody's existing degree of market power for
21 example that you didn't want to disturb?

22 **MR HEAPS:** No, we don't look to interpret the market and other
23 participants.

24 **MR CURTIN:** Thank you for that. The last question I just want to
25 understand very clearly what your position was on Part F.

26 I understand that obviously there's the backstop issue,
27 and as long as that's adequately resolved perhaps it's going
28 to be harder to get to coalitions because people realise
29 there's still an out at the back of the process.

30 If we could sort of abstract from that a little bit and
31 look at the formation of coalitions. I suppose I'm wondering
32 why you're endorsing Part F -- excuse me if I'm being a bit
33 obtuse because there have been similar questions -- that you
34 seem to be saying Part F isn't going to solve the voting
35 coalition issues that you have instanced, but you have given
36 Part F at the same time some tempered or warm degree of
37 support.

38 Is it really only as a step towards thinking about
39 multilateral solutions, or do you feel more warmly about
40 Part F than that?

41 **MR HEAPS:** We do, we believe that in certain -- in many
42 situations that Part F would be an improvement because it
43 builds on the status quo by adding a multilateral decision-
44 making process, and we believe that in many situations that
45 that could actually be very beneficial.

46 But we are concerned that in some situations that
47 coalition may not develop to enable projects which are
48 required for net public benefit to go ahead, therein and,
49 therefore, we are concerned that the appeal process a too weak
50 to allow us to appeal in those circumstances.

Transpower (cont)

1 **MR CURTIN:** Okay, so it unlocks some but not as much as other
2 arrangements might?

3 **MR HEAPS:** On the Transport Working Group one of the gaps we've
4 seen, or what we believe we've identified that there is a need
5 to work through several examples -- case studies -- to test
6 Part F to see what actually happens. Now, that work has
7 really just been started. At the last Transport Working Group
8 I was asked to produce some of the examples and so we're now
9 producing them in draft. One set of those examples is being
10 worked on by a subgroup, so they're still very much in their
11 infancy.

12 However, each time we work through an example we find
13 that there are complexities with Part F such as linked between
14 Part F and Part C; all the time it takes you to complexities
15 and you have to establish some assumptions, some assumptions
16 about service definitions assumptions about behaviour in
17 coalitions. So there are still I think a few rough edges , if
18 you like, to be resolved on how Part F interacts.

19 Our core problem is, whether it doesn't work, whether
20 the wrong solution isn't -- when the wrong solution is coming
21 out of the process, who steps in? Transpower steps in at the
22 present time, who steps in under Part F?

23 **MR CURTIN:** Thank you.

24 **MR CARVELL:** Can I make two comments to follow-up. I think again
25 Bill's characterised this appropriately in terms of, our
26 support for Part F is based on the fact that if coalitions can
27 form to resolve these multilateral investment issues, then
28 that's great. But we are cognisant that there are a number of
29 risks which in certain circumstances which may come to pass
30 where coalitions might form or the right decisions won't get
31 made out of that.

32 So the access to the backstop is necessary in that
33 environment. So, that's no different to the standard
34 Government policy that, let the competition rule where it can
35 but have some regulation where you need it for exactly the
36 same analogy.

37 One other comment I'd like to pick up is, you mentioned
38 the consequence perhaps of having access to the backstop in
39 that that might maybe alter behaviours through the voting
40 process. One thing to bear in mind in terms of the operation
41 of the backstop as it's described in Part F is, the voting is
42 based off a price methodology which is determined under
43 Section 3 of Part F.

44 So, effectively it's worked out how much proportionally
45 people will pay for the solution; they vote on those
46 proportions. Currently one of the significant problems is
47 this issue of hold-out and the potential for Transpower to
48 play this backstop role. A consequence of that is often that
49 the parties who hold-out benefit, because the costs get
50 allocated in a different way than they otherwise might be

Transpower (cont)

1 allocated. That was considered by the Transport Working Group
2 and the solution to that was that, when the EGB considers the
3 solution, it will then allocate -- it will then implement the
4 solution using the same allocation of costs that the parties
5 used to vote. So, you can't escape from the allocation of
6 costs simply by holding out any more. At least that's how
7 Part F is designed to work.

8 So, I don't think you have quite the same risks of a
9 backstop investor under the -- certainly the counterfactual as
10 we describe it -- that you might currently have under the
11 status quo where Transpower is put in that situation and then
12 seeks to recover its investment as best it can.

13 **MR TAYLOR:** I just wanted to take you back, Mr Heaps, to the
14 conversation you had maybe a quarter of an hour ago about that
15 Auckland situation where there were three issues, one of which
16 you determined and as I understood you to say -- I may be
17 wrong -- I understood you to say that you went ahead with the
18 investment.

19 I assume you are saying you went ahead with it and then
20 you weren't actually to make a charge for the investment you
21 went ahead with. That may be an implication.

22 **MR HEAPS:** No, we went ahead without a contract. The assets that
23 we installed then came on to the ODV register.

24 **MR TAYLOR:** They became part of your core grid?

25 **MR HEAPS:** That's right. The issue there is we made the
26 investment and Transpower took the risk of those investments
27 in the future being stranded. So a new investment contract
28 would have given us protection against those assets.

29 **MR TAYLOR:** Against an ODV write down.

30 **MR HEAPS:** Yes, and therefore that pushes some of the risk out to
31 the marketplace and then they make the decision on the
32 investment. In fact, we took that decision back in and took
33 the stranding risk on the assets.

34 **MR THOMSON:** We left the decision as late as we can,
35 Commissioner, we left it. The board made that decision to
36 invest that money because it's outside our normal business
37 cases and everything, and we leave it as late as we can, but
38 it's still being a bit safe.

39 **MR CARVELL:** And a consequence of it entering our ODV and being
40 charged under that basis is that the costs fall differently
41 had we had contracts.

42 **MR TAYLOR:** I understand that. That's a key point, I understand
43 that, thanks.

44 **MS BATES:** I just wanted to make sure. You're putting forward
45 that you prefer a Part F decision-making model over the model
46 whereby EGB makes a decision after consultation? You actually
47 positively prefer Part F as a decision-making...

48 **MR ROBERTSON:** Yes.

49 **MR THOMSON:** Yes.

50 **MS BATES:** And why is that?

Transpower (cont)

- 1 **MR ROBERTSON:** I'll answer that. I think Mr Heaps has stated
2 that as well, and I will repeat it --
- 3 **MS BATES:** Okay, I just want to be clear about it.
- 4 **MR ROBERTSON:** I think it is because we -- I could cheat, I've
5 actually got Professor Hogan's transcript open here and I
6 think he made the same point, which is one that we would
7 endorse; that is, we're not sure how big the possibility for
8 market led investments might be, but it could be significant
9 and critical and it allows that sort of breadth of innovation
10 into the solution, and we think that's worth pushing for.
- 11 **MS BATES:** So the model you prefer is having more industry
12 participation and, therefore, support --
- 13 **MR ROBERTSON:** The model being a Part F process, yes.
- 14 **MR TAYLOR:** Just to explore a little bit further, we've been
15 having a bit of a conflagration up here after your last reply.
16 In effect the default situation, as you define an
17 investment as necessary for adequate grid security, and you
18 wait as long as possible, I understand that, but then if you
19 still decide -- if you can't get the coalition together, you
20 invest.
- 21 **MR THOMSON:** At the present time.
- 22 **MR TAYLOR:** At the present time, yes. This may be a naive
23 question: What would be wrong with that being the default
24 situation in buying Part F into the future?
- 25 **MR THOMSON:** Can I answer this? The problem is that you have an
26 industry EGB with guiding principles different from the
27 Government Policy Statement. Transpower cannot enter into a
28 contract where the guiding principles are liable to drive the
29 contract away from the Government Policy Statements, and we
30 get caught in between the two. The Government EGB, the
31 counterfactual, actually allows the objectives on Transpower
32 and on the Government EGB to be identical with the Government
33 EGB being in charge. But the other one doesn't, and I've
34 thought -- Commissioner I've thought about this a hell of a
35 lot, I've been on EREC for 18 months sitting there thinking --
36 I mean, it doesn't work leaving Transpower in the backstop
37 with an industry EGB.
- 38 **MR TAYLOR:** You will understand we're coming up to speed here, so
39 some of the questioning is trying to get us there.
40 With an industry EGB, would there not be an incentive if
41 Transpower was the ultimate backstop, in the sort of
42 circumstances that the example was given to us, wouldn't there
43 be an incentive as time moved on and there were investments
44 made that did enter the charging base and then were allocated
45 on the basis that the participants didn't want; wouldn't there
46 be an incentive over time for participants to more and more
47 and more get in behind the coalition and, therefore, their
48 resort to last resort would be less and less prevalent?
- 49 **MR CARVELL:** It's hard to see what the distinction is between
50 that scenario and the status quo.

Transpower (cont)

1 **CHAIR:** Well, if you look at the status quo where by default you
 2 pick it up, as Mr Heaps said, and then take it on as part of
 3 your core assets in your ODV valuation, which uses the basis
 4 for transmission pricing generally. Then over time -- to
 5 follow Mr Taylor's point -- if I was in Southland having to
 6 pay for a refusal by others in the north to stump up for an
 7 expansion in the north, then eventually I'd make it pretty
 8 clear to Transpower so that the people in the north did start
 9 paying directly.

10 **MR ROBERTSON:** But how would you express that preference?
 11 Through your voting under the arrangement? Southland won't
 12 get much of a vote under this arrangement.

13 **CHAIR:** One assumes a lot of this will take place before votes
 14 would actually happen. The voltage support issue that you
 15 mentioned earlier; eventually as people outside the areas
 16 affected start to pay for it, one assumes that informally
 17 positions will start to change over time. I mean, voting is
 18 usually preceded by a fair bit of discussion and debate as to
 19 why you are voting.

20 **MR ROBERTSON:** Yes, but that discussion must surely be influenced
 21 by the prospect of succeeding in a vote arrangement.

22 **CHAIR:** That will certainly be an influence but over time one
 23 wouldn't expect these situations to be static. I leave you to
 24 think about it anyway.

25 **MR HEAPS:** It seems to me, really, you're talking the pricing
 26 methodology.

27 **CHAIR:** That's right.

28 **MR HEAPS:** And that is all about winners and losers. Whilst
 29 there may well be an incentive on somebody to form a coalition
 30 because they are a winner, there's a disincentive on another
 31 to form a coalition because they are a loser, and that's why I
 32 think it would be very difficult for those coalitions to form.

33 **MR THOMSON:** Can I add something else. In my opening remarks I
 34 tried to make it very clear that the responsibility for the
 35 security policy for the country shifts across outside
 36 Transpower -- not the implementation, that stays with the
 37 system operator -- the policy shifts across. You can't have
 38 your cake and eat it too and that's what you are trying to
 39 have. You are trying to have the policy go across to the EGB
 40 at whatever type, and the backstop being Transpower, because
 41 security is largely about -- it's about energy investment and
 42 transmission investment really, and I think you've got to do
 43 it properly.

44 I mean, I've always found that where you get
 45 accountabilities and control muddled up and in the wrong
 46 places, you get trouble. And I don't think you can have your
 47 cake and eat it too, and that's what you are proposing,
 48 Chairman, and there will be furious debate about this.

49 **CHAIR:** We're just trying to flush out the various sides of the
 50 argument; we're not putting a proposal to you.

Transpower (cont)

1 **MR THOMSON:** Don't worry, there will be considerable argument in
2 other places about this.

3 **CHAIR:** I'm sure. The fact that it's been a major issue in this
4 hearing is evidence of its important.

5 Well, look, I just wonder whether this will be a time to
6 draw it together. I think we plan to start again tomorrow at
7 1.00 with Transpower, and that will be followed by NZEM I
8 think, Bill.

9 **MR NAIK:** I think they are picking up on Friday now.

10 **CHAIR:** Therefore we will go from 1.00 o'clock until Transpower
11 is finished and that will give the applicant time to reply.
12 Is that satisfactory, Mr Thomson?

13 **MR THOMSON:** Yes.

14 **CHAIR:** And, Mr Kos, your okay with that?

15 **MR KOS:** I guess it depends on how long it will take to finish,
16 but yes. Is there some flexibility on Friday?

17 **CHAIR:** We certainly would like to finish Transpower tomorrow,
18 and we'll start at a time when you're ready to respond.

19 **MR KOS:** I don't think we'll be more than a couple of hours.

20 **CHAIR:** It's not so much that, it's giving you time between
21 Transpower finishing and preparing your response.

22 **MR KOS:** That's why I raised the possibility of timing on Friday
23 because, if we're no more than two hours, we would perhaps...

24 **MR NAIK:** There's time scheduled for 10.30 to 11.00 NZEM, with
25 applicant right of reply beginning at 11.00, 11.30 for two
26 hours.

27 **CHAIR:** Okay, 11.30ish on Friday and moving through till you
28 finish.

29 All right. Look, thanks Transpower, and we'll break and
30 resume say at 5 past 3 with Todd, I think, who's next. Thank
31 you.

32

Adjournment taken from 2.50 pm to 3.05 pm

33

34

35

36

37

38

39

40

41

42

43

44

45

46

47

48

49

50

PRESENTATION BY TODD ENERGY

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45
46
47
48
49
50

CHAIR: All right, we'll reconvene. I'd just like to welcome Todd Energy and I guess make a couple of points. We try and be pretty informal Mr Tweedie, and really leave it over to submitters to make their points. Commissioners usually ask questions, and I'm sure you'll do your best to answer them. I just thank you for altering your timetable, about three times, to suit the Commission, of which I am much appreciative. So, without further ado, I'll ask you to introduce your team and commence please.

MR TWEEDIE: Thank you, Mr Chairman, Commissioners. I'm Richard Tweedie Managing Director of Todd Energy. On my right is Rodney Deppe who is an economist, an experienced member of our management team, and he will be taking you through our formal presentation. On my left is Babu Bahirathan who is an electrical engineer, heads up our commercial group in the electricity sector, and was an employee of Transpower for ten years. He, in latter part of his time there, intimately knew their pricing methodologies and is a source of constant contestability in our business with Transpower in terms of pricing practices there. So, Babu is a very useful person to answer questions Commissioners might have. Charles Teichert, Peter Reidy, and Phillip Talacek are with us as well.

I'd just like to just give a few introductory words before Rodney presents you the formal part of our presentation. I probably don't need to remind the Commission that the electricity industry in New Zealand is very much dominated by the state. Transpower is a monopoly and the three SOEs lead to the state having a very dominant position in the electricity sector.

The private sector; really, there's two larger parties that are generator/retailers, namely Contact and Trust Power, and of course NGC is a generator but with no retail customers after the debacle of last year where they lost -- they went from largest retailer to not being a retailer at all.

Putting us in context, we are there but are a relatively small player and, from that point of view, we do perhaps have a somewhat unique perspective as a small player because our business isn't large, we have to watch costs, we have to watch margins, and we are very concerned about what we do see going on in this market at the present time. Of course, we're very concerned about where it may be going in the future.

We initially entered the industry in 1996 with the objective at that time of bringing stranded gas to market, and we did that initially through the construction of the relatively large cogen plant at Kiwi Dairy Companies in Hawera which now produces electricity for what is meant to be -- what they say is the largest single site dairy plant in the world and we export electricity as well to the grid and produce a

1 lot of steam.

2 From that we have slowly grown our business in a modest
3 way to have a mix of thermal, geothermal and hydro generation
4 with retail customers, but again, I emphasise very much at the
5 smaller end of the scale compared with the other players I've
6 mentioned.

7 So we've been in this game for a relatively short period
8 of time, but we have learned quite a bit. Our overriding
9 impressions are that the state is too heavily involved, and
10 exercises huge market power. Transpower, in our view, is not
11 accountable enough for its actions. The NZEM is hugely
12 bureaucratic and far too expensive and, above all, it's a very
13 difficult and risky business to be in.

14 The threat by Government to introduce a Crown EGB if it
15 in fact did implement that threat -- I'm not too sure in fact
16 whether it would -- would be a further detriment in our view
17 to any chance of a truly competitive market. We say that the
18 applicant's application is flawed. It is in fact, in our
19 view, less competitive than the status quo. We propose that
20 any new governance Rulebook should meet the test of being more
21 pro-competitive than both the status quo and any possible
22 Governance Board. Using only the latter -- namely the
23 Government Governance Board -- as the counterfactual is a far
24 too low a threshold to climb over in our view. The threshold
25 should be at least the status quo.

26 This application in our view entrenches a substantial
27 reduction in competition -- and examples of this we will cover
28 in Mr Deppe's presentation -- are the loss of bilateral
29 trading, bilateral trading as of right, which is hugely
30 important to our business and I understand other
31 generator/retailers. We accrue a considerable efficiency
32 saving through bilateral trading in our group, and to have our
33 hand forced that we have to trade only under one set of rules
34 under one structure forever and a day is, frankly, an
35 appalling proposition.

36 In our view, the dominance in the voting power of
37 generators -- and we'll discuss that with you -- is a further
38 example where these rules have some very unsatisfactory
39 outcomes. We are also concerned about the transmission voting
40 power not being wide enough and, because of that, it results
41 in inefficient incentives, a lack of contestable pricing, and
42 disincentives in our view to distributed generation.

43 So, we're going to cover all of those points and I'll
44 pass over to Rodney to commence our presentation.

45 **CHAIR:** Thanks, Mr Tweedie. Mr Deppe please.

46 **MR DEPPE:** Thank you. I have 40 or 50 slides to cover, and I'll
47 do that as efficiently as we can. The topics we're going
48 cover; we're going to quickly review the industry objectives
49 against which we'll look at the proposals and the other
50 practical options. Then we're going to look at the issue of

1 bilateral trading as the first example where we see a
2 substantial reduction in competition.

3 We are then going to look at the dominance in the NZEM,
4 transmission incentives, contestable transmission pricing,
5 distributed generation. We're then going to have a quick look
6 at the Russell McVeagh letter and what advantages some of
7 those offer and some of the changes that probably need to be
8 made. Then we'll sum it all up in our conclusions.

9 Just very quickly, and this is the overall perspective
10 of course which we're coming from, is the reason that we're
11 actually all here, is to try and at least keep our head above
12 water with the OECD. The history over the last decade has
13 been that we haven't actually been relatively equal to the
14 OECD; in fact, in comparison to the OECD, we've declined and
15 the Treasury is quite concerned about this. So much so,
16 they've set up a special unit to investigate this. They've
17 come to the conclusion that the reason is low productivity.
18 We actually are talking about low productivity today and I'll
19 give you a number of examples of that in this industry, and it
20 includes of course losses, distributed generation and all the
21 other competition issues which we're going to deal with.

22 This, of course, goes without saying. This is, the
23 economic welfare is maximised by vigorous competition. I
24 won't go through all of those in detail, but the key ones of
25 course we're going to talk about today are going to be
26 maximising competition between markets, in other words that's
27 a removal of bilateral trading in competition with the NZEM
28 and the issue of dominant behaviour and ensuring that demand
29 side participation occurs as well.

30 The industry objectives; the industry structure, will
31 only maximise productive efficiency if pro-competitive new
32 innovative ideas can be implemented and competitive market
33 freedom is maximised. This immediately leads to the principle
34 that, if the number of votes is a function of dominant size
35 then, an increase in dominance rather than competition is a
36 likely result. That principle, we'll see, reverberates right
37 throughout the rules in the voting structure.

38 The maximising competition requires minimising
39 collective decision-making. And unfortunately there are a
40 limited number of collective decisions that have to be made.
41 However, they are fairly limited and they really relate to
42 MACQS reconciliation between markets as distinct from
43 reconciliation within markets and energy balancing.

44 The potential industry structures which we have before
45 us -- and I've proposed five possibles -- we have, first of
46 all, the status quo which is the NZEM and MARIA where in here
47 you can see the structure is basically, the NZEM compete with
48 MARIA, and we'll deal with that in some detail later on in the
49 presentation. We have also the proposal which is that the EGB
50 governs MACQS, NZEM, but MARIA is deleted or abolished. So,

1 from our point of view, we see that as a reduction in
2 competition.

3 The Crown EGB is a similar structure except for the
4 possibility that MARIA may or may not be there. It's not
5 clear from the elucidation of the Crown EGB at this stage, but
6 the big problem that we see is that there is a conflict of
7 interest with the Crown having both the dominant interests
8 inside the industry and also being the regulator of the
9 industry, which we can see as a big problem which will
10 definitely, in our opinion, reduce competition.

11 Then we have what I would call quasi-competition. This
12 would be that the EGB includes the NZEM and MARIA trading, and
13 that's quite possible, that simply the existing MARIA
14 structure trading and the NZEM existing MACQS, and within the
15 EGB structure we think that's an eminently sensible structure.
16 We, quite frankly, don't understand why we have to lose the
17 element of competition between MARIA and NZEM.

18 Of course, then subsequently in the future it is quite
19 possible that we enable the EGB structure to move towards an
20 even more competitive structure, in other words, potentially
21 that you can have trading between -- rather, competition
22 between different markets, in other words, NZEM or an
23 alternative NZEM, MARIA and an alternative MARIA. There
24 should obviously be that contestability if we believe we are
25 talking about competition rather than something other than
26 competition.

27 Having a quick look at each Crown EGB, we see that the
28 Crown own 70% of generation, 100% of transmission and, of
29 course, the Crown EGB will maximise dominant shareholder
30 control of the market, which is obviously a concern for us,
31 and protection of SOEs will see competition and innovation
32 inhibited. This will be particularly a problem in respect of
33 distributor generation where, of course, distributor
34 generation acts as a competitor for both remote generation and
35 transmission. We'll deal with that later.

36 The proposal, industry EGB, will mean that all physical
37 trading must take place through a single multilateral trading
38 monopoly; that means the abolition of bilateral trading. This
39 seriously erodes competition between markets, causes
40 inefficiency in the market services market, and collective
41 parties have the sole vote on transmission services. The
42 proposed voting structure inhibits the adoption of pro-
43 competitive rule changes.

44 So, if we attempt some ranking of these options, we see
45 that both the proposal and the Crown EGB are less competitive
46 than the status quo, and then of course you ask a simple
47 question, which Richard mentioned earlier, what is the sense
48 of having an EGB structure which is less competitive than the
49 status quo from a competition perspective? The status quo,
50 quasi-EGB and fully competitive EGB all seem practical and

1 more competitive than the proposal.

2 **MS REBSTOCK:** Can I just stop you there, if I can. You will
3 probably be familiar that the authorisation process in the
4 Commerce Act requires us to compare the proposal, the net
5 economic benefits from the proposal compared to what we think
6 is the counter -- most likely counterfactual. So, when we do
7 the competition, when we do our analysis of the net economic
8 benefits or detriments, it's really not over to us to choose
9 to compare it to the status quo unless we think the status quo
10 is the most likely thing that will happen absent the proposal.

11 So, what I'm not sure of is -- I hear you say you prefer
12 the straight status quo to the Crown EGB, but I'm not sure
13 you're also saying you actually think that the status quo
14 should be the counterfactual we use for the purposes of doing
15 the net benefit analysis.

16 **MR DEPPE:** Well, you could certainly. The fact that the status
17 quo is more competitive is first of all relevant, we believe,
18 because the NZEM and MARIA competing with each other is
19 relevant. So, in consideration of the counterfactual we have
20 to take into account efficiency so, therefore, that becomes a
21 relevant consideration. Not the only relevant consideration,
22 but a relevant consideration.

23 **MS REBSTOCK:** But for the purposes of the Commerce Act the
24 comparison we have to make, it's the net benefits of the
25 proposal compared to the net benefits of what we think is the
26 likely counterfactual.

27 **MR TWEEDIE:** Can I say that the issue -- the only issue why the
28 Crown EGB is a possible counterfactual is, basically, the
29 statement of the Minister, that he will introduce -- or
30 through the legislation, the position he's got now, he will
31 mandate that be implemented. But there's no certainty,
32 there's no absolute assurance that is the case. One thing is
33 absolutely clear, that the counterfactual today would be the
34 status quo, because that is what exists and will exist --
35 exists today and is certainly in the short-term, and maybe the
36 longer term, the practice that continues.

37 I have great difficulty -- we have great difficulty in
38 saying, because the Minister says "X", immediately that has to
39 become the counterfactual. Therefore, we have gone a step
40 further and said, because of the uncertainty of all of that we
41 are submitting to the Commission that whatever the
42 counterfactual may be, whatever you so choose, our proposition
43 to you is that, whatever this application is about should be
44 more pro-competitive than either of those two, whichever you
45 choose.

46 **MS REBSTOCK:** Can I just come back to how certain is the
47 counterfactual with respect to the Crown EGB. This isn't just
48 something the Minister has said, it's actually provided for in
49 legislation.

50 So, Parliament has said that this is what will happen

1 should an industry EGB through this process not proceed. Not
2 only will it -- they've made it quite clear that this is a
3 time constraint process, so I wonder if there isn't more
4 certainty than just what the Minister has said. Because I
5 agree that certainly it's been the tradition of the Commission
6 to look beyond simple statements of what might happen by a
7 particular Minister when we decide on the counterfactual. But
8 in this case we actually have legislation that provides for
9 it, and so, I wonder what ability or what the logic could be
10 that could take the Commission away from that.

11 **MR TWEEDIE:** Well, could I suggest there's nothing certain in
12 politics. Though there may be empowering legislation, there
13 still has to be an active step taken by the Government of the
14 day to actually implement the Crown EGB. It's not just going
15 to drop out of the clouds if it has to be an active conscious
16 step by the Government of the day.

17 Now, the last Government certainly encouraged a
18 direction to take place by the industry of its own initiative,
19 and I don't believe any Government would ignore what's
20 happened and the process that this Commission is going through
21 right now. There is, I'm sure, a lot of useful informed
22 submissions coming to the Commission which the Government --
23 the last Government -- certainly wouldn't have had the benefit
24 of that contestable advice and considered review. If, at the
25 end of the day, the Commission concluded that the application
26 was in fact flawed, whatever counterfactual it chose, it would
27 be unlikely in my view that the Government would ignore that
28 outcome. It would not make sense, if one was looking at the
29 national perspective and benefit, that you are reducing
30 competitive outcomes, when in fact the last Minister of Energy
31 has constantly been saying publicly he wants to increase and
32 improve competitive outcomes. I cannot believe that any
33 Government would want to take a backward step. If the
34 counterfactual that is chosen, namely -- and if you chose the
35 status quo, and the status quo is in fact more pro-competitive
36 than the Crown EGB, and if you were looking for an outcome
37 that was more competitive than the status quo, I'm sure the
38 Government of the day would think that is a worthwhile
39 objective and conclusion that you've arrived at.

40 **MS REBSTOCK:** I'm not sure, but you seem to be suggesting that
41 the Commission can indicate a preference in what it thinks
42 would be the best approach rather than strictly follow the
43 terms of the Commerce Act, which says we simply make the
44 comparison. I say "simply"; it's really not simple, but we
45 make the comparison between the proposal and the
46 counterfactual. You seem to be suggesting that we should go
47 beyond that brief and basically indicate what we think will be
48 the best competitive outcome.

49 **MR TWEEDIE:** Our submission is that, how can the Crown EGB be a
50 realistic counterfactual when you have got no solid reliable

1 information on what that's going to be? You have not got, in
2 substance, something to measure a proposal against if you
3 choose the Crown EGB as being the counterfactual. That's the
4 difficulty you face.

5 Unfortunately many people -- many of the submitters have
6 argued that has to be the counterfactual because that's what
7 the Government has said. But no-one has gone beyond that and
8 tested that -- as far as I can see tested that argument. But
9 the bottom line is, you have not got an absolute clear-cut
10 framework as to what the Government of the -- the future
11 Government of the day might intend to put in place. You have
12 with the status quo.

13 Our submission to you is that, if you have to choose --
14 and I'm not arguing about the fact that you do have to choose
15 one -- it should be the status quo because that is clear; that
16 can be very clearly identified. We should be testing the
17 application against that.

18 **MS BATES:** What is not clear, though, is that the Government
19 would be likely to stay with the status quo. In fact, I think
20 the legislative intent would be not to stay with the status
21 quo.

22 **MR TWEEDIE:** Again, that is not absolutely clear. There have
23 been broad generalised statements made, and I believe the
24 Minister is wanting to see -- would wish to see outcomes, the
25 Government would wish to see outcomes that are going to, in
26 fact, reach an output that is better than the status quo.

27 I cannot believe we have embarked on this huge expensive
28 exercise that ends up with a result that's worse than what
29 we've got now. That's possible, but being rational people --
30 and governments can be rational -- I don't think they will
31 intend that.

32 **CHAIR:** Look, I think -- let's progress a bit. I'll just make a
33 couple of points. Without going through the Act in detail,
34 the absolute default position towards a Crown EGB is when an
35 industry EGB hasn't performed over two years against
36 performance standards. That's the absolute. I think we
37 certainly note your view, no question about that.

38 At the end of the day, the decision we make on this
39 particular application, as was said, will compare with what we
40 view of the counterfactual right or wrong, but I think it's
41 pretty clear what you see it as. It may be in the absolute
42 one or the other can prevail. The default position is
43 specific in relation to an EGB not performing over two years,
44 I think it is.

45 If the Minister wants to have a Crown EGB, certain
46 processes have to take place. One could envisage, just for
47 argument's sake, there could be a hiatus where the status quo
48 carried on. Whether it's better or worse than the
49 counterfactual is a matter of opinion. We certainly not your
50 view on it. Let's proceed.

1 **MR DEPPE:** In any event, I think you would have to take a view
 2 with respect to MARIA. So, for example, if you're talking
 3 about the Crown EGB, would the Crown EGB include MARIA or not
 4 include MARIA in competition with the NZEM? You have to take
 5 that view anyway, and our strong belief is that, unless the
 6 Minister wants to remove competition between markets, then
 7 MARIA would have to stay.

8 So, particularly if the Commission turned down the
 9 proposal on the basis that there was a reduced amount of
 10 competition between markets, I'm sure the Minister would take
 11 that into account when he formed the Crown EGB. So,
 12 therefore, the appropriate counterfactual on that basis must
 13 be including a bilateral trading, which means competition
 14 between NZEM and MARIA.

15 The alternative basis of course is, if you turned it
 16 down. What would happen is that the EGB -- and if you turned
 17 it down for the reason that MARIA was not there, of course
 18 they would have a look at that and work out whether they
 19 wanted to put it in, or they could put it in. In other words,
 20 that would be a continuation of the status quo under the guise
 21 of the EGB.

22 **CHAIR:** There may be a number of options. If we turned it down -
 23 - and I'm not saying we've come to a decision at all, we
 24 haven't -- if we were to turn it down, the applicant may go
 25 away and see the reasons for the decline and revisit the
 26 proposal; I don't know.

27 Whether immediately the Government would move to set up
 28 a Crown EGB was the question Mr Tweedie's just asked. In
 29 practice things would drift on one way or another, at least on
 30 an interim basis. Let's take the view that -- your own view
 31 is that the Crown EGB is not necessarily the counterfactual
 32 for those reasons and we obviously note those and see where
 33 you're coming from.

34 **MR DEPPE:** I'm sure the Minister would take note of the
 35 Commission's reasoning in coming to whatever conclusions it
 36 comes to.

37 **CHAIR:** One would hope, when we do write a decision, people will
 38 read it. I hear what you're saying, and thanks for taking us
 39 through it. Mr Deppe, back to you.

40 **MR DEPPE:** We're now going to look at examples. We have noted
 41 the Commission has asked questions and was quite interested in
 42 examples of competition or anti-competitive activity or less
 43 than competitive activity which -- and so, we're going to go
 44 through some of those. We believe that these are pretty
 45 important because they do illustrate behaviour and the
 46 workings of the market at the moment. We're going to deal
 47 with those five topics; bilateral trading, dominance in the
 48 NZEM, transmission incentives, contestable transmission
 49 pricing and distributed generation.

50 First of all, dealing with bilateral trading. We do

1 have a tool at the moment, the Todd pool which, the Todd pool
2 in itself competes with the NZEM pool. The NZEM pool is just
3 a pool. We run a very similar pool, these are our
4 participants. Nine participants, and that includes King
5 Country, Freshstart, Bay of Plenty Electricity, Mangahao Joint
6 Venture, Kapuni Cogen, Kiwi Cogen, Edgecumbe Cogen, Aniwhenua
7 and Kawerau, and some of those are owned by other parties, the
8 joint ventures, and King Country and Freshstart so we
9 certainly -- it certainly has a mix of ownership within that
10 structure. The bilateral trading functions --

11 **MR CURTIN:** Just for our information, how many megawatts are
12 involved here? What's the size of this pool?

13 **MR DEPPE:** It's approximately about 1,000 gigawatt hours. It's
14 approximately balanced in terms of retail generation in the
15 total pool.

16 Todd manages multilateral/bilateral contracts between
17 buyers and sellers, and we manage the pool for these
18 participants. The pool matches generation to load in
19 competition with the NZEM. The clearing and settlement is
20 carried out internally, and members are able to self-insure
21 against counter-party and contractual risk. In other words,
22 if you have retailer generation you're able to effectively
23 ensure your own counter-party risk. Whereas that's not
24 possible in the NZEM, provides significant cost reductions for
25 must-run generation.

26 The benefits of the Todd Pool are that we get a 60%
27 saving on NZEM variable trading costs, and we produce a saving
28 of half a million dollars per year compared with the NZEM
29 costs. For a small player that is pretty significant -- and
30 particularly when a lot of these costs are fixed costs, you
31 can see that that makes a big difference to entry, which is a
32 big factor in competition.

33 The Todd pool only purchases services from the NZEM if
34 those services are required; in other words, we do in fact put
35 Mangahao into the NZEM, because we want the merit or the
36 dispatch for that particular generation. So, where we want a
37 service, we pay for that service; where we do not want that
38 service, then it becomes redundant. The reduced third party
39 default risk; recently Phoenix defaulted in the NZEM, created
40 a loss which everybody is going to have to take a hit on. We
41 don't have that problem in our pool and so the default risk
42 is -- we're not able to manage default risk inside the NZEM
43 and whatever problems occur there we have to take that.

44 **MR CURTIN:** Just coming back to the default risk, explain to me
45 again how that's handled in your pool?

46 **MR DEPPE:** Basically what happens is that, in this particular
47 case Phoenix didn't pay its bills and so basically everybody
48 has to stump up and takes a loss because Phoenix didn't pay
49 its bills. This occurred in the last few weeks actually.

50 In our pool we manage it internally amongst ourselves

1 and if somebody doesn't pay their bill on the retail side,
 2 well then, we're not going to pay them on the generation side,
 3 for example. So, we have an ability to manage it in a
 4 slightly different way, and amongst the parties, and we don't
 5 have the same problem that we would have in the NZEM.

6 So, in other words, we provide our own contestable way
 7 of managing default risk, which is slightly different to the
 8 NZEM. An NZEM way is not necessarily the best way. This is
 9 all about innovation, which is all good competition. We just
 10 do it in an alternative way, which we find better for the
 11 structure of the particular small participants that are there.

12 For example, none of them have got a standard pause(?)
 13 rating; huge cost to get a standard pause rating. We do
 14 require that they have certain security rating from a default
 15 point of view and we're able to, for example, accept hedges
 16 and these kind of things as security. So, we have a lot more
 17 flexibility than the NZEM.

18 **MR CURTIN:** If a pure retailer goes down in your pool, what
 19 happens?

20 **MR DEPPE:** If a pure retailer goes down, it will depend on the
 21 security that we had for them. In our pool, they've got
 22 generation or they've got hedges. So, if those are lodged as
 23 security, we would take the value of those. Or, if that
 24 wasn't enough, we would want them to make it up with a bank
 25 guarantee; or the balance sheet that they've got.

26 So, they can offer security on a managed negotiated
 27 basis, and it's done on a case-by-case basis; whereas of
 28 course the NZEM being a large pool dominated by the large
 29 players, they dictate the default risk which they start with
 30 again at a pause kind of rating, because they do that anyway
 31 as a matter of business course, whereas small businesses or
 32 private businesses don't do that. So, therefore, they don't
 33 have that cost, don't having to go to that cost, but there are
 34 other equivalent ratings which you can judge people by. You
 35 don't have to have a standard pause rating.

36 NZEM forces must run distributor generators to pay for
 37 merit order dispatch. This is a service which the NZEM
 38 offers. Bilateral trading does not. To must run distributed
 39 generators, merit order dispatch is a problem, not a service.
 40 Dominant generators want smaller generators to cross-subsidise
 41 payment for their Merit Order Dispatch.

42 So, whereas we have certainly heard the complaint that a
 43 lot of the large dominant players have said that you are free-
 44 riding, our response to that is that we do not want the
 45 particular service that you are offering. Merit Order
 46 Dispatch, where we do want it, then of course we pay for it.
 47 In fact, we do. One of our hydro stations wants it, then they
 48 pay for it. They are an explicit member of the NZEM. So, you
 49 have the contestability.

50 **CHAIR:** Can you take Mangahao out of that if you want to?

1 **MR DEPPE:** We can take it out right now; in fact, it's only gone
2 in the last six months, a year. Two years. Prior to that it
3 was out.

4 The Todd pool competes with the NZEM pool. The proposal
5 removes potential competition to the NZEM thereby increasing
6 costs, reducing manageable risk, stifling investment in
7 generation and retail, as NZEM fixed costs make small
8 operations uneconomic.

9 The proposal abolishes bilateral trading. Bilateral trading
10 should be retained.

11 **CHAIR:** Just to interrupt you again; sorry, a thought occurs.
12 Much has been made by some submitters of a reduction in the
13 numbers of participants in NZEM. I think there were figures
14 of 30 odd retailers or traders being quoted when the market
15 started, now down to about 10 or 15; I'm not sure, but
16 certainly reduced significantly.

17 **MR DEPPE:** I think it's also significant that their response to
18 that has been, they want to force players to be a member
19 rather than looking to reducing the costs. If they look to
20 reducing their costs, which is the appropriate competitive
21 response, then that would be more understandable, but that's
22 not been their response.

23 **CHAIR:** Just adding to that, a lot of that reduction of numbers
24 will have occurred because of amalgamations and links between
25 retailers and generators, but have any of those smaller energy
26 traders for example migrated from the NZEM pool to your own
27 pool, and are managing to survive in the smaller environment
28 with smaller companies?

29 **MR BAHIRATHAN:** They used to be outside of NZEM, even before we
30 started it. We started our pool in October 2000. People like
31 King Country Kiwi Cogen and Mangahao used to be outside of
32 NZEM using bilateral trading, and they've come into our pool
33 now, which we run. Phoenix used to run it in the past to us;
34 we manage it now, since October 2000. They're quite happy,
35 they don't have any large fixed costs; only one membership to
36 NZEM comes through the Todd membership with NZEM and MARIA,
37 and we trade for everyone.

38 **CHAIR:** On behalf of other members of the pool?

39 **MR BAHIRATHAN:** Correct.

40 **MR DEPPE:** Mangahao Joint Venture would be an interesting
41 example. Mangahao, when it was owned by ECNZ -- we purchased
42 it in 97 -- they were dispatched by ECNZ in those days. That
43 would have been part of the market in those early days. Then
44 we took it over and we took it outside of NZEM into MARIA and
45 then subsequently of course we put it back into MARIA later,
46 in the last year or two, back into NZEM.

47 **CHAIR:** This is the one up the road here isn't it, in Palmerston?

48 **MR DEPPE:** In Shannon yes.

49 **MR BAHIRATHAN:** It's a good example of how we dispute the free-
50 riding issue, the Mangahao one. Mangahao, the reason it's in

1 NZEM, it's got discretionary water; it can store a bit of
2 water and it can run on a specific price. If there is a price
3 struck, then it will run. MARIA bilateral trading doesn't
4 allow that flexibility for us and most of us small plants
5 don't need that flexibility, therefore, it's much cheaper for
6 us to just run as a must run plant and we do our own clearing
7 and settlement. Whereas, Mangahao, we've chosen to go into
8 the NZEM to pick up the good prices, especially when we are
9 short of water. So, there's no free-riding issue in our view.

10 **MR DEPPE:** A lot of our plants are cogens which, of course, have
11 to run for the factory, not --

12 **CHAIR:** They're using steam made from the waste for the factory
13 aren't they?

14 **MR DEPPE:** That's correct, so they can't shut them down because
15 the factory needs the steam.

16 We're now going to deal with dominance in the NZEM. The
17 key issue in dominance in the NZEM, we certainly saw this last
18 year, and it's useful to reflect on the world energy counts
19 produced in a fairly large report in the middle of last year
20 where they recommended that 20 to 25% of excess generation for
21 competition or effective competition in a market to exist. We
22 actually measured this, and at peak winter times, in the
23 winter crisis in June/July last year, it was down at 15%,
24 which of course means that we've got potentially a problem.
25 Then, when we looked at the size of each of the large
26 generators, this is the four largest generators, individually
27 are all between 16 and 30% of the market capacity. So, in
28 other words they are all, each individually of them larger
29 than the excess capacity that is not dispatched at the peak
30 times of the market, which then by definition means that each
31 one of these large generators will have to be setting the
32 market price at that time. So, in other words, it gives them
33 dominance and enables them to set the price.

34 Now, that clearly is an issue for us. That was one of
35 the reasons why we complained about the Taranaki constraint at
36 the time, and the Minister actually acknowledged that and let
37 more volume into the market in August, which dropped the price
38 \$150. So, this issue that we've already seen there play out
39 and it dropped the market price by \$150 between July
40 and August, and that was a serious issue.

41 When we look at this issue in voting we see that voting
42 entitlement is based, as proposed, on one megawatt purchased
43 for one vote; in other words, megawatt hours are the effective
44 denominator, that's for purchases and for generation. An
45 analogy -- if we can draw an analogy -- to Parliamentary
46 Elections, is basically saying that the dollar annual income
47 earns you a vote. We're saying that the voting entitlement
48 should rather be more democratic, if we're wanting this to be
49 countervailing power, and I'll deal with this in some detail
50 later, that it should be based on one generator for one vote

1 and one purchaser for one vote.

2 Dominance is measured in megawatt hours market share,
3 and obviously then voting entitlement is measured in megawatt
4 hours, then the degree of dominance is the criteria for
5 determining the voting entitlements and dominance will be
6 entrenched by the voting structure. If the voting structure
7 is to foster economic welfare, it must be pro-competitive and,
8 therefore, act as a countervailing power to dominance.
9 Retailers' votes are supposed to act as countervailing power
10 to generators, but vertically integrated generators will
11 always vote retail gigawatt hours in favour of generation.
12 The reason that they will always do that is, generation is
13 worth around ten times more than retail and, therefore,
14 generation interest will overwhelm the process and retail
15 votes for vertically integrated parties will never counter-
16 vote generation. We have an example of this, just to
17 illustrate the point. Sorry, did you want to ask...?

18 **MS REBSTOCK:** I was going to ask if you're sure that a one vote
19 per participant really gets over the problem as opposed to
20 having it relate to the size of the participant?

21 **MR DEPPE:** Well, if size and dominance is the problem that we are
22 trying to prevent, then surely we can't base voting on that.
23 That's a starting position. You then come to the solutions to
24 that, and indeed there are a number of them. We believe that
25 you should only get one vote if you're a player because we're
26 only talking about the rules and why should, just because you
27 are big, mean that whatever you say means it more or has more
28 truth or validity about it as far as competition is concerned.

29 I would have thought the small players' opinion is much
30 more actually important than the large player, because the
31 small player is much more concerned about dominance. The
32 dominant player is actually more concerned about maintaining
33 any dominance that he might have.

34 **MR CURTIN:** We had a wee bit of a conversation, I think with
35 Transpower, and they were saying if there's an issue of market
36 power, maybe the design of the market Rulebook isn't the place
37 to address that. I mean, let's have a design that looks like
38 overseas spot physical market designs, and let's address
39 issues of market power outside issues of market design.

40 Now, I'm merely just parroting this back as an argument
41 that was put to us. You are taking a rather different line
42 and saying really that the market design should almost take
43 market power considerations into effect when -- yeah, it
44 should be another item in the arsenal, if you like, in
45 addressing market power issues.

46 **MR DEPPE:** Yes, we definitely are saying that. We would say that
47 the -- the whole EGB is there to set up a structure to deal
48 with, hopefully, innovative pro-competitive elements that
49 possibly need to be introduced in the future. So, in other
50 words, it recognising that it's an evolving process, nothing's

1 static. In that environment you really do then have to
 2 address the issue of dominance because, if you don't, well
 3 then, the dominance will permeate all the decisions that come
 4 and flow from that. The evolution of that will simply be the
 5 structure that has been set up. The structure will dictate
 6 the nature of the decisions that flow from that structure.
 7 So, that's why structure is key; absolutely key.

8 I mean, you see this in all walks of life in science and
 9 biological structures. What comes out of the particular
 10 system is determined by the structure of the system, and so,
 11 it's just a scientific fact and I think we'd be remiss in not
 12 recognising that.

13 **CHAIR:** Sorry to keep interrupting, but if you distilled it in
 14 NZEM operation thus far, the generator/retailer interface,
 15 whereas you said earlier most if not all are linked; would you
 16 see the generators prevailing from a generation perspective or
 17 are they indeed operating in the market as retailers?

18 **MR DEPPE:** Where I referred to vertically integrated generator, I
 19 was referring to a generator as in some of these examples here
 20 before us, where the retailer is a similar size to the
 21 generator. So, for example -- and that is the case at the
 22 moment -- let's, say, take party B there, where you have 25%
 23 of the retail market and 25% of the generation market --
 24 assuming that I'm correct in my presumption -- generation
 25 interests are worth a lot more than retail interests, then of
 26 course it means that they'll always tend to side on the
 27 generation side when it comes to a contestable issue between
 28 retail and generation. That being the case, they'll vote
 29 their 50% in terms of generation interests and, of course,
 30 because you've got generation and retail both 100%, obviously
 31 the denominator if you like is 200%, so the 165 you have to
 32 divide by 2, but you quickly see that they're -- pretty much
 33 generation's got 80% of that vote, in that example, it's just
 34 to illustrate the point.

35 The large vertically integrated generators have market
 36 power in the NZEM right now, which has been a continual
 37 problem going forward, the proposed Part G voting structure
 38 entrenches this dominance. Lack of countervailing voting
 39 power ensures generation considerations will take precedence
 40 in all decisions. Voting rights for Part G must be
 41 reallocated and consumers should be granted voting
 42 entitlements. That's what we believe; just to re-address the
 43 balance. And, by the reallocation, I mean it should be -- one
 44 party should have one vote. We'll summarise that.

45 **MS REBSTOCK:** How would you bring consumers in?

46 **MR DEPPE:** Well, I see in the overall structure of course
 47 consumers are given, I think, it's a third of the vote. This
 48 is the overall part A. Certainly, they'd have to be allocated
 49 an overall percentage as opposed to the other groups. And
 50 then, of course, there'd have to be an election process as

1 part of that.

2 **MS REBSTOCK:** We've had some other players indicate to us that
3 they will object strongly to consumers having any say over
4 their operations or their asset values. You don't seem to
5 share that objection.

6 **MR DEPPE:** Well, we're looking at it from an industry structure
7 point of view. We're not looking at it from the point of
8 view -- they're not going to tell us how we're going to
9 operate our assets, anything like that. They're really going
10 to say what is the market structure? In other words is a
11 consumer going to benefit from competition between a MARIA
12 structure and an NZEM structure? Likely to, yes.

13 Some of the larger generators might not have that as an
14 overriding imperative. So, therefore, you've got an immediate
15 difference and the issue for us in deciding structural issues
16 is deciding what is going to give us a better competitive
17 outcome, what structure, and if we included consumers, not so
18 that consumers dominate the proceedings, but consumers
19 certainly have a say; is that going to introduce more
20 competition or less competition? If it's going to introduce
21 more competition in terms of countervailing power to any
22 dominance, then it should be a good thing. So, therefore, it
23 should be allowed, in our view.

24 We're trying to take as an objective view of the
25 competitive markets that in fact we can, and because we're a
26 smaller player, the fact we can do that, and as with all
27 competition, small players, their view tends to be more pro-
28 competitive because they benefit from the competition rather
29 than they disbenefit from the dominance, because generally
30 they are the recipient of the dominance.

31 Transmission incentive: Voting rights are limited to
32 Transpower 50% and connected parties. This is in Part F. The
33 following groups, therefore, are disenfranchised, domestic
34 consumers, commercial consumers, industrial consumers,
35 retailers, distributed/embedded generators. In other words,
36 which are not connected, parties that bear the ultimate cost
37 of transmission have no say. I think that's pretty important,
38 that.

39 The high constraints and losses: There exist numerous
40 major grid constraints. They are up and down the country and
41 these have persisted over many years, and they are clearly
42 getting worse. If anybody is in doubt about that, just have a
43 look at the rentals. The rentals are going up each year. So,
44 that only means that the losses and constraints must be going
45 up. The constraints generate transmission rentals which are
46 distributed to connected parties. Transpower only contracts
47 with connected parties, therefore, no incentive exists for
48 Transpower to invest in grid infrastructure or make
49 operational changes that will reduce transmission rentals.

50 So, the voting structure entrenches inefficiency because

1 constraints lead to rentals, higher rentals, that goes to the
 2 connected parties who have all the voting power and,
 3 therefore, they have an incentive not to alleviate any of the
 4 constraints. So, that doesn't seem to me to be pro-
 5 competitive.

6 By the way, that same discussion, that same argument is
 7 exactly the argument on marginal loss rentals which we've
 8 presented in other papers. The distribution networks have
 9 interests aligned with Transpower as distribution networks and
 10 pass on 100% of transmission charges to retailers without
 11 competitive restraint. Common interests exist to protect all
 12 networks from competitive pressures, and they retain rentals
 13 or FTR auction revenue.

14 Part F, voting under transmission incentive, parties
 15 have an interest in seeing changes to the system have no
 16 votes. Now, we refer to distributed generators and end
 17 consumers. We'll deal with those in some more detail later.
 18 In addition, retailers, consumers and distributor generators
 19 should have Part F voting rights. That is a proposal that we
 20 make and we mention that in more detail in our conclusion.

21 **MS REBSTOCK:** I wonder how you make the comparison between with
 22 respect to these issues; is it an improvement over the status
 23 quo or the same or is it -- with respect to the Part F voting?

24 **MR DEPPE:** Certainly -- I'm not sure whether I've got your
 25 question correct, but what we're really saying is that
 26 retailers, consumers, and distributor generators, if they had
 27 voting rights, you would have more countervailing power within
 28 the transmission Part F structure and, therefore, you're
 29 likely to get more competition out of that structure.

30 **MS REBSTOCK:** I guess I'm standing back from what might improve
 31 the proposal from what it is in your view, and I'm asking you,
 32 compared to what happens now in these areas, would the
 33 proposal represent an improvement over the status quo?

34 **MR DEPPE:** We certainly deal with that precise issue in a moment
 35 in respect of transmission pricing, and also in terms of
 36 distributed generation later on.

37 **CHAIR:** Let's come to that as you move through then.

38 **MR DEPPE:** All right, we'll do that. In fact, we come to it
 39 right now, contestable transmission pricing. The ability to
 40 contest transmission charges is an important constraint on
 41 Transpower's monopoly behaviour. This is the current
 42 situation which I think you refer to.

43 No leave under the proposal to contest connection
 44 charges imposed by Transpower, once the pricing methodology
 45 has been approved. We give you some specific examples of
 46 what's happened historically, and we can certainly give you
 47 more, but we'll go through these.

48 At Kapuni cogen, pre-development Transpower quoted
 49 connection charges of \$0. In fact there's a contract which
 50 says as much. Kapuni paid for all connection assets and

1 therefore logically it should be \$0.

2 Post development connection charges increased to
3 \$420,000. We say that, if the charge was \$420,000, initially
4 the cogen would not have connected to the Transpower system;
5 it had an alternative, it could have connected to the PowerCo
6 system.

7 **CHAIR:** Was this unilaterally, or?

8 **MR DEPPE:** Yes, just unilaterally; they decided that they wanted
9 to change and introduce these charges.

10 **CHAIR:** You didn't have a contractual right to stick to the
11 earlier figure?

12 **MR DEPPE:** No, it was a term contract. When the contract
13 expired, basically they had a right to do this.

14 **MR BAHIRATHAN:** Their contracts are one year contracts and at
15 every -- in 1996 Transpower introduced a five year contract.
16 After that, when they expired in 2000, there've been an annual
17 contract, so Transpower's able to change pricing every year as
18 it changes on 1st of April.

19 **CHAIR:** As the contract changes, I see. A similar comment
20 applies to Mangahao?

21 **MR DEPPE:** Yes, at Mangahao the charges -- when we purchased this
22 hydro station from ECNZ, the charges were \$130,000 post
23 purchase. Again, that was after we had a two year contract;
24 we purchased it with a two year contract, and we assumed that
25 the two year contract charges of \$130 per annum were going to
26 stay at that level. Not so, they went up to \$1.2 million;
27 that's an 800% increase.

28 We, obviously, immediately contested that and we were
29 able to supply, immediately, evidence to show that it should
30 be reduced. It has been reduced by more than half, and
31 there's probably some way to go in that. But, nevertheless,
32 it shows that being able to contest makes a substantial
33 difference. Mangahao, by the way, is a modest sized
34 generator, 25 megawatts.

35 **CHAIR:** Yeah, it's not very big, is it.

36 **MR DEPPE:** Therefore, these kinds of levels of charges make a
37 huge difference.

38 **CHAIR:** I've got a feel for the proportion of charge, but it's
39 not a large power station, is it?

40 **MR DEPPE:** No. Of course, we're talking about distributor
41 generation -- as we'll come to in a second -- these kinds of
42 uncertainty make a huge impact on whether you're likely to
43 build a station or not.

44 **CHAIR:** Just come back to the question that was asked a minute
45 back. You don't see a Part F process at least addressing some
46 of those issues? A Part F process --

47 **MR DEPPE:** If the Part F process introduced allowed us to contest
48 that as part of the Part F; in other words, we had voting
49 rights as part of that, and the people who are paying the
50 charges, namely consumers and generators, had voting rights,

1 then of course that would help.

2 **MR TWEEDIE:** The current Part F is a continuation, basically, of
3 the status quo.

4 **CHAIR:** Although I think, Mr Tweedie, it has been seen by the
5 applicant of course, but by other parties thus far as
6 representing an advance on the current situation, given that
7 if it -- there have been qualifications similar as you can
8 imagine, but there does seem to be some acknowledgement that
9 it does provide an avenue to start getting into some of these
10 transmission issues, the Part F proposal, with qualifications.

11 **MR TWEEDIE:** We don't see that. We see it as entrenched --
12 because the voting rights are controlled by Transpower and
13 connected parties, they will continue to support a
14 transmission pricing structure that does not serve contestable
15 outcomes, and we continue to get the results we're getting
16 here now.

17 In fact Transpower, when they were having difficulties
18 with connected parties on some of these pricing issues, they
19 did manage to persuade the Minister, unbeknown to anyone else,
20 certainly us, to pass; I think it was a regulation decreeing
21 that from a certain date we were not allowed to challenge the
22 pricing methodology, and when we get to some of these
23 examples, in a nutshell the pricing methodology, the ODV
24 methodology that Transpower uses, we have the nonsense
25 situation that some of these increases are generated on the
26 basis of a piece of paper that says we have notionally built a
27 line from A to B, despite the fact that it's never been built
28 in practice and we ignore the actual physical connection.
29 This has happened at Hawera and we increase connection charges
30 by up to 1,000%.

31 The inability to transparently challenge Transpower on
32 that sort of behaviour is hugely damaging to competition in
33 the marketplace, and it's a huge disincentive to distributed
34 generation being built. Some of these further examples will
35 continue to show this. At every one of our points of
36 connection with Transpower we've had this done to us as one of
37 the smallest players in the industry, and yet we'll give you
38 another example with one of the state generators with the
39 connection through to Manapouri; that line has not been
40 treated as a spur as these are for us. That state generator
41 has had favourable treatment and the whole transmission is
42 paying for that spur.

43 So, we have these inequitable outcomes and outcomes that
44 are very much damaging to competition and smaller entrants.

45 **CHAIR:** I'm not taking a view on who's right and who's wrong on
46 that one. You make the point and make it obviously quite
47 strongly. But the principle as I understand it -- and I'm not
48 saying Part F is the answer to a maiden's prayer either -- but
49 the point that has been said to us by a number of submitters
50 that it may provide at least a forum and avenue whereby there

1 can be some transparency in developing longer term
2 transmission pricing principles. Your position I think is
3 that in spite of that, unless you have a major share of the
4 voting power, it doesn't amount to much.

5 **MR TWEEDIE:** That is our point: We believe that the applicant
6 should go away and resubmit another application to you that
7 addresses these very issues, because now is the opportunity to
8 get this right for today and future generations. If we get
9 this wrong today, or in the next period of time in this
10 application, and we embark on something that's half-baked and
11 flawed, we will live with that for, I would suggest, our
12 lifetimes at least.

13 Now is the opportunity to get it right, and the
14 applicant should go away, with a gentle shove from your good
15 selves, and re-present his case, and he will if you so insist.
16 Already Russell McVeagh has preempted something, and with a
17 gentle shove from yourselves, he will. The points that we are
18 raising here can easily be addressed by him.

19 **MS BATES:** You've said that you accept that constraints of the
20 grid are a major problem. If Part F was modified in the way
21 that you are suggesting, do you think that would go a
22 significant distance to helping address the problem of under-
23 investment?

24 **MR DEPPE:** The parties that are affected by under-investment are
25 not the distribution companies, and certainly not Transpower.
26 The parties that are affected by under-investment are the
27 consumers and the generators. They are the parties that are
28 affected, but they have no say. So, if the major issue before
29 us is under-investment, then surely then of course the parties
30 that are affected not being represented, how can they -- how
31 could they possibly address that issue?

32 **MR TWEEDIE:** But your question was, if this happened it would
33 definitely help because it might not fix under-investment per
34 se by Transpower, but it would help new entrants who want to
35 build distributed generation and want to have a pricing regime
36 that is equitable, is transparent, is predictable, and has a
37 consumer interest ultimately at heart.

38 So, our proposal will be a worthwhile step to achieving
39 a better balance and a better representation of interest
40 groups, customers through to generators, distributed
41 generators like ourselves. We have the ridiculous position at
42 Hawera where we are physically connected to a Transpower
43 substation. We have customers in south Taranaki, and
44 Transpower will not contract with us because, despite the fact
45 we're a connected party, they will only contract with the line
46 company.

47 Now, there is an issue there about significant breaches
48 of the Commerce Act, Section 27 etc, but we have; and the
49 Commission has actually looked at this, why should that
50 continue? Why should Transpower only contract with one of two

1 connected parties and say to the other connected party, we
2 will not contract with you because we have a contract with the
3 other party and that connected party, namely the line company,
4 because of this monopoly anti-competitive arrangement -- is
5 charging around a 500% markup on Transpower charges.

6 So, Ms Bates, that case has been studied at length. We
7 are disappointed the Commission has not taken this further on
8 a complaint of ours, and we certainly are looking at taking it
9 further with Transpower because that's a classic factual case
10 that exists today as to the collusion of two monopolies --
11 namely, the local line company and Transpower -- to actually
12 contract to prevent other connected parties, let alone other
13 retailers contracting directly with them. So, a change to the
14 voting structure, as we're proposing, would go a long way to
15 ensuring there's a more contestable debate on these issues by
16 a range of parties than currently occurs under the present
17 regime.

18 **MR CURTIN:** Just before you leave Kapuni and Mangahao, these
19 examples that you quote from, your perspective were they --
20 these increases, were they individualised to you or would they
21 have been in the context of some general rebalancing or
22 general price increase that Transpower was doing?

23 **MR TWEEDIE:** We maybe getting a bit paranoid and maybe we
24 shouldn't be condemned for that. We have the view, rightly or
25 wrongly, everywhere we seem to turn we get a whack around the
26 ear by Transpower, and yet Transpower publicly proclaims that,
27 because of its changing ODV valuation, its revenue is
28 decreasing, its more efficient, it's this and it's that. But,
29 in every one of our cases, the opposite has occurred. We are
30 one of the smaller innovative players, why do we end up -- if
31 it was one occasion, maybe, but it is in every one of our
32 cases.

33 So we get suspicious and say, well, maybe there is
34 collusion between the state entities; the beneficiaries may be
35 the state generators, but certainly a pro-competitive smaller
36 player like ourselves has not received any of those so-called
37 benefits, it's all been detriments.

38 **CHAIR:** Can I make one point again, without taking a view on it;
39 certainly, I suppose complaints is too strong a word, but
40 comments about Transpower, both negative and positive, have
41 been made right through this hearing by state generators plus
42 and minus as well. So, I don't think -- at least in front of
43 us -- we've seen them visibly holding hands, as it were. But,
44 I hear what you're saying.

45 **MR TWEEDIE:** Well, if we take the example -- the biggest example
46 where it's a position opposite to what Transpower is doing to
47 us; that is a beneficiary to a state generator. I think it's
48 Meridian -- is Manapouri. If we go through this example to
49 highlight this case, which is favourable to Meridian, is
50 opposite to the way Transpower are treating us on all of the

1 examples we give you.

2 **MR DEPPE:** The Manapouri -- this is an 80 kilometre an hour spur.
3 The policy that they've got is that all spurs will be paid by
4 the party for which the spur is effectively built. So, in
5 this case it's built for Manapouri; the line doesn't go
6 anywhere else. Clearly it would never have been built if
7 Manapouri was not there, and it is only a 220 line. So,
8 clearly Meridian in this case is the owner, they should be
9 paying for this, and the amount of money they should be paying
10 for this 80 kilometre line is probably of the order of 6 to \$7
11 million. Now, of course, they don't pay that, the consumer
12 pays that.

13 Now, you ask the question why. In comparison to this
14 particular situation at Hawera; at Hawera it actually is part
15 of the grid, as you can see. This is taken off Transpower
16 maps and it's not a spur, but Transpower deems that it's a
17 spur. How they deem it's a spur is like this. This is the
18 ODV system and what they do is they create a fictitious double
19 line. If you go back to the previous line they'll see there's
20 a double line between Hawera and Stratford. If you go look at
21 the next one you'll see there's a double line there suddenly,
22 that's a fictitious double line. They charge for a fictitious
23 double line because that's the ODV and therefore they've made
24 a spur.

25 **MR TWEEDIE:** But they've also disconnected between Waverly and
26 Hawera, the physical connection between Waverly and Hawera
27 they've disconnected in their ODV model to justify the price
28 increase they impose upon you.

29 **MR DEPPE:** So it's not actually a spur but they've deemed it to
30 be a spur.

31 **CHAIR:** Can we go back to the principle. I hear what you're
32 saying and it's illustrated there. I haven't got quite enough
33 information to debate with you obviously on that particular
34 one. But the principle, if the development of Transpower
35 pricing methodology, using Part F as a basis for working
36 through this, was to enable better participation by all
37 parties, you'd see that as an improvement on the current
38 situation.

39 **MR TWEEDIE:** We're saying our proposal would be an improvement on
40 the current situation.

41 **CHAIR:** You think the applicant's proposal is still driven by the
42 votes in relation to Part F?

43 **MR TWEEDIE:** Yes, it will entrench -- the applicant's application
44 on this point entrenches the power that line companies and
45 Transpower already have.

46 **CHAIR:** All right, that's where you get -- I note the point.

47 **MR DEPPE:** When it was mentioned earlier that some of the
48 participants might have felt that there was a benefit of the
49 current proposal, might have been obviously line companies
50 because they've got 50% of the vote. I'm not sure about that,

1 but they would be an obvious contender for saying that there's
2 an improvement.

3 **MR CURTIN:** Could I just ask one question without getting too
4 much into the details here. You've sort of fingered either
5 ODV or Transpower's use of ODV as behind this kind of
6 arrangement and you've kind of shaken my belief in ODV to an
7 extent if -- I'm not quite sure what's going on here. Is it
8 the -- explain to me how you think the ODV system is requiring
9 this to be done.

10 **MR DEPPE:** Maybe Babu could address this because he was the
11 pricing manager.

12 **MR BAHIRATHAN:** Not pricing.

13 **MR DEPPE:** What were you? You talk to that.

14 **MR BAHIRATHAN:** Your question is why are we getting charged like
15 this?

16 **MR CURTIN:** Yeah, you've got a physical configuration and then
17 you've got this notional configuration which it's been
18 suggested to us is in some way an artifact of the application
19 of the ODV handbook or the ODV pricing methodology. I just
20 want to understand why it is, in your view, that the ODV --
21 why this has come about as a result of the ODV element.

22 **MR BAHIRATHAN:** The ODV hasn't changed in the whole period
23 actually for Hawera in terms of charges. We'll give you the
24 example for Hawera charges. When the plant was built and
25 connected to Transpower in 1998, the connection charges were
26 about \$36,000 a year. Transpower changed the pricing
27 methodology on 1 April 99 and due to that, just the pricing
28 methodology changed, nothing else changed. The actual grid
29 stayed the same, the ODV remained the same within the Hawera
30 area. The prices, though, went up from 36,000 to nearly
31 400,000 a year. I must say 1 April 2002 they've come back
32 down to 36,000, right through the period. Nothing changed in
33 the physical system apart from the ODV went from a radial fee
34 from Hawera for a double circuit back to the actual system.

35 **MR TWEEDIE:** The only reason for it changing, ultimately, is that
36 this particular example has been presented to governments, to
37 the -- what was the Commission of inquiry?

38 **MR DEPPE:** Electricity inquiry.

39 **MR TWEEDIE:** Electricity inquiry etc. Our view has been that
40 ultimately Transpower have probably been embarrassed enough to
41 bring it back down as of 1 April 2002 to the number that it
42 originally was. But its been a huge exercise to achieve that.
43 But along the way they stood by their ground that they had
44 constructed this position that we -- the spur and they said
45 that was legitimate. They can optimise their transmission
46 network and price accordingly, and they did it.

47 We have, though, similar issues at Mangahao that still
48 continue which they will not come back to the previous number.
49 But they have come back to the 36,000 here after two years of
50 paying. We have not paid them the higher charges but, you

1 know, if we have to have these scraps every step along the way
2 and it's getting tighter all the time, because now Transpower
3 probably gets tired of these scraps so they go to the Minister
4 and say look, you know, people aren't paying their connection
5 charges, we better pass a bit of legislation to sort this out
6 and further entrench what they are in fact able to do.

7 **MR BAHIRATHAN:** Also Transpower in their recent submission seemed
8 to have referred to Kiwi Cogen and not having a connection --
9 our refusal to sign a connection contract, which is untrue
10 actually. We actually have a connection contract we were
11 forced to sign in 1998 before we connected, so there was a
12 connection contract signed and a new investment contract and
13 when the prices went up in 1999 we went on posted terms. We
14 refused to sign then a revised connection contract. We did
15 originally have a signed connection contract. Obviously we
16 will be prepared to sign a connection contract now that the
17 prices have come down again.

18 **CHAIR:** You're right, there is a reference in their submission to
19 that location. Okay, I think just coming back to the point,
20 in your view if the voting weights under Part F were changed,
21 that could be an improvement in the status quo in relation to
22 transmission pricing.

23 **MR BAHIRATHAN:** Mmm.

24 **MS REBSTOCK:** Can I just ask you just for clarification, was Todd
25 Energy involved in any of the working groups that led to this
26 application?

27 **MR TWEEDIE:** Not really. I mean again, this is a conscious
28 decision we have to make in this business is that we are
29 small. To have a resource to be intimately involved in every
30 step along the way is beyond our means and we make a
31 contribution and make a comment as and when we can. But we
32 certainly have not been involved intimately in the detail of
33 the design -- we've obviously paid for it because we've had
34 to, but we certainly haven't had an intellectual or human
35 input into the process.

36 **MS REBSTOCK:** So you haven't commented on proposals before they
37 came to the Commission.

38 **CHAIR:** I'll perhaps take a two minute break. Its purely a
39 question of timing, so if we could just give the Commission --
40 sorry.

41 **MR TWEEDIE:** I was just going to say, the only point I have
42 commented on, I was at a meeting and I raised it with David
43 Caygill the issue of this removal of bilateral trading, and my
44 impression was that he was concerned about that and his answer
45 to me was you can always seek an exemption. I remember saying
46 something like seeking an exemption from the major generators
47 that would have the power of control, and that answer did not
48 seem to me, why wouldn't -- if there was an issue there, why
49 wasn't it addressed now and fixed now.

50 The answer to that, though he didn't say it, the answer

1 I concluded was the reason it's not there now is because the
2 major generators don't want it there. But that's the only --
3 hardly call that a contribution, but that was the only
4 discussion I've had of any consequence.

5 **CHAIR:** Anyway the applicant may wish to comment on: When the
6 applicant sums up.

7 **MR TWEEDIE:** Yes, I'm sure he will.

8 **CHAIR:** Can we just adjourn for two minutes? My guess is you'd
9 need at least another half an hour to adequately deal with the
10 submission. I'm very conscious of giving people the time they
11 need rather than what is set down. Being realistic 5 o'clock
12 would be the earliest I think one could see this coming to a
13 conclusion. Can we just adjourn for two minutes? Thank you.
14 Stretch your legs.

15

16 **Adjournment from 4.27 pm to 4.33 pm**

17

18 **CHAIR:** I suggest we reconvene. Back over to you.

19 **MR TWEEDIE:** Mr Caygill, I didn't realise was behind me.

20 **CHAIR:** I was trying to give you a subtle hint to turn around.

21 **MR TWEEDIE:** He's just reminded us that we actually did -- the
22 final point the Commissioner asked us, had we made any
23 submission prior to this application. We have, contrary to
24 what I told you, but it was pretty limited. Mr Caygill agrees
25 that we certainly had drawn to his attention the issue of
26 bilateral trading. But some of these other issues have really
27 only been addressed by us in light of this application. So we
28 have done something on a limited basis.

29 **CHAIR:** Thanks to you. Back to you Mr Deppe.

30 **MR DEPPE:** This is really just a conclusion on contestable
31 transmission pricing which is, the ability to contest charges
32 provides an important constraint to a monopoly provider, as
33 we've seen, and the voting rights on pricing methodology lie
34 with connected parties. We think that's a serious flaw.

35 In fact I would go so far as to say that that particular
36 issue is actually potentially anti-competitive, because it
37 links the connected parties issue to the limitation on
38 Transpower's contracting. The distribution companies have an
39 incentive to collude with Transpower, therefore transmission
40 pricing must be contestable as Transpower faces no
41 countervailing voting power. You'll see this point come out
42 more clearly as we go through later.

43 **CHAIR:** One of the Commissioners made the point when we had the
44 break, again I'm purely postulating, I'm not taking a
45 position, I make that very clear, we haven't made a judgment
46 on anything. The line of your argument would be that the
47 voting arrangements under Part F in theory could give a
48 situation where concerns you may have may not get addressed in
49 the default option because under the statute, as I understand
50 it, if the industry can't agree on transmission pricing it

1 gets thrown to us, I think, or the Minister has the option.
2 I'm not sure where we'll throw it after what you've just told
3 us, but that's the issue. Under the voting structure at the
4 moment, decisions could be made under that voting structure
5 which may not deal with this issue.

6 **MR BAHIRATHAN:** Just to add to that, our concern comes from the
7 fact that the line companies who are the majority of the 50%
8 other than Transpower, they have no incentive to reduce or
9 increase line charges because they pass it through to the
10 consumer. So, they don't have to contest any pricing
11 vigorously and they don't. That's our concern. Any
12 methodology then different, in my view, to any pricing that
13 comes out, as long as they can change their charges to the
14 retailer to pass it to the end consumer, they haven't got real
15 problems with Transpower's pricing.

16 **CHAIR:** Although there is a bit of a dichotomy there, some people
17 have commented, line companies, that they made reductions in
18 charges and indeed those haven't been passed on by retailers.
19 In fact in another context there's a hearing next month on our
20 proposals for a threshold approach to price control. Some of
21 the submissions which I'm sure you'll have seen on our website
22 from line companies have asked that question in reverse. If
23 we bring our charges down, or if the charges come down because
24 of the regime the Commission has proposed, how can they
25 guarantee they'll be passed on to consumers? So it's the same
26 argument in reverse there.

27 **MR TWEEDIE:** You could ask the same question of line companies on
28 lost rentals, some pass those through to consumers and others
29 don't. I mean we know some definitely do not pass those
30 through.

31 **MR BAHIRATHAN:** Just in reply to that, to your question, the key
32 difference between line company passing it on and the retailer
33 not passing it on is that the retailer will face competition
34 from another retailer who's willing to pass it on, whereas the
35 line company doesn't have that competitive element.

36 **CHAIR:** I'm sure that will be debated at some length in the
37 context of those other parties -- the main party. As I said,
38 one of the Commissioners made in the break, you've confirmed,
39 under the current structure the default option may not take
40 care of the problem you raise. That's all I'm asking.

41 **MR TWEEDIE:** It will be the continuation of a happy merry little
42 club of people.

43 **CHAIR:** That's your comment, not mine. Because I do make the
44 point that there has been some support and some criticism of
45 Transpower, so I could not accept that they're a happy little
46 club, but that's your view, that's fine.

47 **MR TWEEDIE:** I wasn't suggesting it was your view, it was my
48 comment.

49 **MR DEPPE:** So, summary on this in Part F voting rights should be
50 also be allocated to retailers, consumers and distributed

1 generators. We're now going to deal with distributor
2 generators and an interesting point is to reflect on what the
3 OECD says about distributed generators and they say that small
4 generators located at or near large electricity consumers
5 known as embedded or distributed generators are an important
6 substitute for transmission services, especially near
7 bottlenecks on the transmission network. Transpower contracts
8 exclusively, however, with distribution companies to inhibit
9 distributed generation.

10 Transpower only contracts with connected parties, the
11 avoided transmission charges are controlled by the connected
12 party, the distribution company. Distribution companies
13 demand up to 100% of the avoided transmission charges, despite
14 the fact that they don't have to invest a cent. So basically
15 that's just what I would call a pure monopoly profit and it's
16 purely taking advantage of the dominance because they don't
17 have to pass the distributed transmission savings across
18 because they charge consumers for -- and they force
19 distributor generators who are in their own distribution area
20 to pay the transmission charges.

21 So, in other words a distributor generator or embedded
22 generator cannot avoid paying for the transmission charges
23 when he sells that electricity to another local consumer who
24 could be just adjacent to him. The only way he can actually
25 capture the avoided transmission savings is if he builds a
26 line, in other words duplicates the entire distribution
27 network. It's the only way he can capture the avoided
28 transmission savings.

29 **CHAIR:** Having said that, there has been development of
30 distributed generation. Would you classify the gas turbine
31 plants in the Auckland region as distributed generation or
32 not?

33 **MR DEPPE:** I wouldn't have got Otahuhu as that, but some of the
34 other ones, some of the smaller ones would be classed as
35 distributed generation, yes.

36 **CHAIR:** One assumes the current Transpower pricing policy hasn't
37 stopped those developments.

38 **MR DEPPE:** No, but if you look around you'll find that they are
39 only the big ones and you'll find that those parties have the
40 same concern that we have, that although they can retain the
41 transmission savings for that particular plant where the
42 generator happens to be, when they try to sell that
43 electricity to the neighbour next door, the neighbour nextdoor
44 has to pay the transmission charges as if the electricity came
45 from the other end of the North Island or the South Island.

46 So, that particular customer is indifferent to buying
47 electricity from the distributed generator next door or from
48 buying it from somebody who gets the electricity from the
49 South Island, assuming this is in Auckland. Now that surely
50 doesn't make -- in other words you have to pay for delivery,

1 whether or not the power has to be delivered.

2 I mean if you take a vegetable analogy, vegetable
3 market, the particular consumer would be indifferent between
4 vegetables that were grown near Auckland and vegetables that
5 were grown in -- on the South Island, simply because you have
6 to pay for delivery from the South Island even if you buy them
7 from close to Auckland. That doesn't seem sensible to me.
8 Nor is it of course sensible in this context either.

9 So in effect what distributed generation is is
10 competition with transmission and of course this is
11 competition with both the distributed -- sorry the
12 distribution company and the transmission company. In other
13 words just the networks. The inability to avoid transmission
14 charges inhibits co-generation development and we believed,
15 probably quite naively, that we would get these benefits when
16 we built the Kiwi cogen. Kiwi cogen is, by the way, the
17 largest cogen plant in the country, Southdown, although larger
18 is not a genuine cogen plant, it's more of a power plant, it
19 only has a steam lead. So, even at the largest cogen plant
20 where we should be able to get these benefits we do not.

21 So, less competition of course results in high energy
22 prices because we can't expand that plant or we're not
23 prepared to because we don't get the benefits. Cogen is more
24 efficient, Kiwi we're about 70, sometimes more than 70%
25 efficient compared to Huntly 35% efficient, therefore CO2
26 emissions are unnecessarily high. Distributed generation is
27 small scale. High NZEM charges makes distributed generation
28 less economic, removal of bilateral trading will constrain
29 distributed generation development as well. We've dealt with
30 that issue.

31 The conclusion on distributed generation, is that
32 distributed generation is the only potential competition to
33 network providers. At present transmission and distribution
34 companies collude to inhibit distributed generation. They do
35 this by -- Transpower for example says that they will only
36 contract with connected parties. I note that that particular
37 criteria is the criteria for voting. That's the reason we say
38 that the voting structure incorporate that particular anti-
39 competitive provision, or what we believe to be anti-
40 competitive. The proposed regime will protect networks from
41 competition by providing Part F voting rights only to
42 connected parties. Part F voting rights must be allocated, we
43 believe, to retailers, consumers and distributed generation.

44 **MR CURTIN:** Just before we leave that, we had a bit of an
45 extended discussion earlier today with Transpower in another
46 context where we were trying to explore how when they were to
47 look at least cost solutions rather than least transmission
48 cost solutions. Transpower's evidence to us I think was that
49 they tended to look quite favourably in theory on distributed
50 generation if distributed generation was technically the most

1 efficient way to get power down from somewhere north of
2 Auckland into Auckland rather than relieving transmission
3 constraint, well that was fine by them.

4 So, I hear what you say, but we also heard what
5 Transpower said. I just wondered before you left the topic,
6 given that we had an alternative view put to us earlier today,
7 whether there was anything else you just wanted to say in the
8 light of that.

9 **MR TWEEDIE:** If I could kick off. I know Transpower do say that.
10 They say it very publicly. But I've also heard even the state
11 generators, I mean Murray Jackson I've heard him publicly
12 being quite critical that though that is said, the actions are
13 quite different from the words. That is precisely our
14 experience.

15 I start from the proposition when I was looking to
16 recruit staff for a position in our organisation, I actually
17 interviewed somebody from Transpower who made it quite clear
18 to me that they had models running looking at what distributed
19 generation did to the revenue base of their business, and
20 clearly it is a threat to the revenue base of their business.

21 When I hear that they had staff looking closely at that
22 and modelling the impacts and looking at approaches to in fact
23 trip up distributed generation, I take note of that. Our
24 practice, the practice we have seen, has confirmed that
25 proposition again coming back to what we argue, the fact that
26 they won't contract with us despite the fact that we're a
27 connected party. If we were able to contract with them, we
28 would be able to deliver Transpower services to our customers
29 in the Taranaki region on a more pro-competitive basis than
30 those customers are having to pay by getting a monopoly
31 service from the local lines company, PowerCo. But Transpower
32 prevent us from doing so.

33 We face -- we do not feel in the whole area of
34 constraint issues that when we look at the pricing methodology
35 the battle we've had with them and we've explained to you
36 there. If you're going to go and build, invest in distributed
37 generation with all these sorts of flow-on negatives and
38 uncertainties and lack of transparency, there's a huge turn-
39 off to in fact doing so.

40 So, quietly, you know, there's a set of practices and
41 behaviour that aren't flashing in lights publicly but are
42 saying to potential developers of distributed generation,
43 particularly smaller scale distributed generation, it's very
44 very hard to do and there's a lot of serious impediments in
45 the way to doing so. We have again at the Kapuni cogen
46 continued to have battles there on pricing and they're still
47 going on today.

48 In all these cases of distributed generation it has not
49 been a ride that would encourage you to do more of it. We are
50 the very people with gas, gas today going forward that others

1 haven't got, that should be more confident about doing this
2 sort of thing. But we are not in that situation directly
3 through our experience to date.

4 **MR DEPPE:** We've modeled -- just on that last point that Richard
5 made -- we've modeled cogen plants in Wellington and the Hutt
6 as well as Auckland because we have an over gas as well where
7 we have a large number of gas customers and we can quite
8 easily look at converting them into cogen plants, more cogen
9 or medium sized cogen. In every one of these situations where
10 we've tried to get these avoided Transpower savings, we've run
11 into the obstacle of having to talk to the line company, the
12 local line company, which says, "sure you can go and build a
13 cogen plant, but I want you to give me all the savings that
14 come out of that", or "go and build it anyway and I'll get the
15 savings anyway". There's always that temptation from their
16 part because Transpower is the only party who will deal with
17 them.

18 So, therefore they will get it inevitably. Transpower's
19 quite aware of this. In the example Richard raised in Kiwi is
20 very interesting. We started in 97 to talk about the subject
21 with Transpower. Their first argument, in fact they raised it
22 with me, their lawyer said, their first argument, "you're not
23 a connected party, that's why we can't contract with you" and
24 indeed they were connect -- we weren't the connected party
25 because we were connected directly to PowerCo at that stage,
26 and PowerCo were connected through, and this was a very short
27 line, 4 to 5 kilometre line, to the Hawera substation.

28 So we said "oh okay, the solution then is we must become
29 a connected party, we'll build our own line". So duly two
30 years later we did, we built the line, we now do have a 110
31 line that connects the largest dairy factory in the world to
32 the Hawera substation. We then contracted with Transpower,
33 got a signed contract, we then asked dutifully, "we're now a
34 connected party, can we get benefits of distributed
35 generation"? They said, "yes, sure, you are a connected party
36 at this point", but at the other point, which was only a few
37 metres away, it was on exactly the same 33 bus, but it
38 happened to be PowerCo line was connected only a few metres
39 away, "you're not the connected party at that bus, so
40 therefore you are not a connected party so therefore our
41 argument is still correct", effectively what they were saying
42 is you have to rebuild the entire PowerCo network for you to
43 get any of these Transpower savings benefits.

44 So, you can clearly see there's a method in the madness,
45 because of course we're not going to go and build a larger
46 generation in Taranaki if we can't get the benefits of
47 building in that location, it makes no sense. So, indeed we
48 still have some difficulty with this cat and mouse game that
49 Transpower keeps playing and we do not understand, we
50 certainly don't believe the argument of connected, being a

1 connected party is an argument that can stand up to rigorous
2 debate.

3 **MR BAHIRATHAN:** Even if you, you know, accept this bizarre
4 situation where, you know, they say you are not connected on
5 the 33, therefore we're not a connected party, can't contract.
6 We have a better example in Mangahao. We are connected at the
7 same point as the line company and Transpower has acknowledged
8 that we have provided transmission services, but if you ask --
9 you know, we were expanding the plant, we are going through a
10 phase of putting a 4 megawatt plant, we could have built a
11 bigger plant if we were going to get some transmission
12 savings. Transpower says "no go and deal with the line
13 company". When you go to the line company they say they want
14 at least 50% of the transmission services before they will
15 start talking to us.

16 So, I mean even though Transpower says that it's, you
17 know, it's encouraging distributed generation, it is only when
18 it comes to if it was going to put distributed generation, not
19 somebody else, who is going to avoid their transmission. It
20 is an alternative for Transpower that it will do to avoid its
21 own investment in network, not somebody else's.

22 **MR DEPPE:** So in a nutshell it's exactly the example of
23 competition that if you were, and from their point of view its
24 understandable, if you were in their shoes possibly, and you
25 had the monopoly, you would probably do everything in your
26 power to prevent competition. That's understandable, but
27 that's certainly not in the interests of the welfare of the
28 country. Effectively that's what we are here today to
29 discuss.

30 **CHAIR:** Let's move on Mr Deppe.

31 **MR DEPPE:** I was going to move on to the Russell McVeagh letter
32 because I thought it was reasonably important and I saw there
33 were a number of questions on it. So we thought we'd bring it
34 up.

35 **CHAIR:** Thank you.

36 **MR DEPPE:** We refer first of all to proposal one which appears to
37 us to be very long and by the virtue of it being long, being
38 detrimental to competition. Todd Energy proposes that the EGB
39 should have the ability to take any rule change believed to be
40 pro-competitive to the rulings panel which is indeed the
41 amendment proposed, or the Commerce Commission at any time.
42 So, in other words we believe that that EGB could act as
43 countervailing power, but it shouldn't be limited to just the
44 rulings panel, it should be in terms of the Commerce
45 Commission as well.

46 So, in other words if there's a pro-competitive rule,
47 then they should have the discretion when dealing with the
48 rulings panel because our concern is that the rulings panel
49 might not be as pro-competitive as they necessarily should be.
50 We certainly have that experience in the NZEM, and that's why

Todd Energy

1 we feel that being able to have the ability to go to the
2 Commerce Commission ultimately would be positive.

3 Proposal 2, exceptions to parts G and H of the Rulebook,
4 we believe as proposed does not go far enough. By that we
5 mean that the ability to move outside of the multilateral
6 wholesale market should be as of right, if certain pre-
7 specified conditions are met. By that we mean that bilateral
8 trading is allowed in MARIA. It's currently allowed right
9 now, it currently works. It works very successfully in
10 parallel with the NZEM and it does not compromise the system
11 security right now. So, why would we reduce competition, why
12 would we lose bilateral trading?

13 We fear that we'd lose bilateral trading forever. In
14 fact we're quite aware that some of the dominant generators
15 have had the removal of MARIA on their agenda for some years,
16 in fact they've said as much over an extended period of time.
17 So, this happens to be just a fortuitous way of going about
18 that. We don't believe that would be pro-competitive,
19 particularly for smaller new entrants. Therefore Todd Energy
20 proposes an additional part C be added to proposal 2 which
21 states, a new rule be introduced approving MARIA rules
22 regarding bilateral trading as an acceptable arrangement which
23 is exempt from parts G and H of the Rulebook. The removal of
24 MARIA bilateral trading is contrary to the EGB's own guiding
25 principles we believe.

26 In conclusion, the industry objective should be to
27 maximise economic welfare. We believe as stated that's a good
28 objective. Therefore industry structure should allow
29 knowledge to be utilised and innovation through the
30 competitive markets, and through that mechanism innovation
31 would maximise economic welfare. Crown EGB is inherently
32 inefficient due to the conflicts that exists. The proposed
33 EGB will reduce competition, therefore the following changes
34 are recommended; voting entitlements on Part G of the Rulebook
35 be adjusted so that vertically integrated companies can only
36 vote on one of the entitlements.

37 **CHAIR:** You mean either as a generator or retailer.

38 **MR DEPPE:** Either or, they should be able to choose. Each party
39 only gets a single vote, consumers be granted voting
40 entitlements. Voting E on Part F of the Rulebook be changed
41 so that distributed generator consumers and retailers all get
42 a vote, voting process changed so the EGB can immediately take
43 pro-competitive rule changes to the rulings panel or the
44 Commerce Commission, that was the proposal I mentioned
45 earlier, Russell McVeagh, and bilateral trading arrangements
46 in MARIA be specified as an arrangement which is exempt from
47 parts G and H of the Rulebook. That's it.

48 **CHAIR:** Can I ask you a couple of questions?

49 **MR DEPPE:** Yes.

50 **CHAIR:** It goes back a couple of slides. We've had a number of

1 submissions in relation to the propositions in the Russell
2 McVeagh letter that regardless of the substance they've come
3 in too late to enable us to fairly consider them. What is
4 your view on that?

5 **MR TWEEDIE:** I mean our view would be trying to be a pragmatic
6 one. I think that's a helpful -- it's a step in the right
7 direction to help the process. Our hope out of all of this
8 would be that this application is not approved and that the
9 EGB governance committee, I think is that what they're called,
10 the Establishment Committee, in fact take on board the key
11 issues and come back with a revised application that meets
12 better pro-competitive outcomes. If the Russell McVeagh
13 letter helps that process, fair enough. But I don't think it
14 should be a slavish adherence to saying it's out or it's
15 absolutely in. I think a pragmatic approach going forward is
16 in the best interests of everyone.

17 **CHAIR:** All right, thank you very much for your time. Also your
18 willingness to be very frank and answer any questions and
19 thirdly for adjusting the timetable to suit, so that's also
20 been important from a process point of view, so thank you very
21 much.

22 **MR TWEEDIE:** It's been no problem, thank you.

23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45
46
47
48
49
50

PRESENTATION BY CC 93

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45
46
47
48
49
50

CHAIR: CC 93, if you'd care to come forward, please: I just welcome CC 93 and just thank you formally for adjusting your timetable to fit in with the Commission, and just to make the point that, take as long as you need, and certainly we'd like to feel that you feel that way. The process is fairly informal, as I'm sure Terence has briefed you. The Commission will ask questions as they come up and we'd appreciate any answers or elaborations. Having said that, it's over to you.

MS PETRIE: Thank you, Mr Belgrave. I just remind you, I know Terence ran through, but CC 93 is made up of the Consumers Institute, Business New Zealand, major electricity users and Federated Farmers. Just to introduce, we have here on the far right Peter Whitehouse from Business New Zealand and David Russell of course from the Consumers Institute, and Terence you've met, and I'm from Federated Farmers.

MR CURRIE: For the record, Katherine Petrie from Federated Farmers.

MS PETRIE: Thank you. As such, we represent business and residential; we represent the big and the small, and we represent urban and rural. Why CC 93 got together, I think it's important to just focus on for a minute. I mean, it is an odd title "CC 93" but clearly it got together in 1993 because we recognised, through the reform process, it was going to be very important to have the strength in the united voice. The only way, really, for us to get adequate resource to monitor and participate in that reform process was by operating together.

My role, only because of -- really, I only became part of this process in 1997, but I did become part of the consumer representation on the establishment board together with a MEUG representative. I had an alternate from the Consumers Institute, and personally I found it an extremely steep learning curve on electricity matters.

I've had a long experience in working with ad hoc policy teams, but it was a whole new jargon and extremely difficult to follow; particularly as the process wasn't one of starting from the ground up, but rather the decision was taken to sort of slam two Rulebooks together; for somebody who wasn't familiar with either Rulebooks, I did find it quite challenging.

But CC 93 has long understood the challenge of being able to foot it against the substantial resources of the, to use Terence's term, gentailers, Transpower, and the monopoly distribution companies. From my own perspective we have a lot of challenge with dealing with the transmission and distribution side, since the consumers I directly represent, Federated Farmers, have considerable exposure in that area.

It's for this challenge that we keep in close and

1 regular communication, regularly meeting and caucusing, to
2 ensure we're addressing all class of consumer concerns.

3 To summarise our general position, what CC 93 wants is
4 that the preliminary view of the Commission should stand; that
5 the offer of imposing conditions be withdrawn. With regard to
6 the EGBL application --

7 **CHAIR:** Sorry, just go back a point. You mean the draft
8 conditions that were sent to us by the applicant, you don't
9 think they should be considered in this context?

10 **MS PETRIE:** That's our view. With regard to the EGBL
11 application, we consider that the proposed Rulebook and its
12 decision-making by chapters will entrench supply side
13 dominance.

14 We do not believe the competing interests in a supply
15 side dominated Rulebook will result in efficient, fair and
16 reliable and sustainable supply to all classes of consumers as
17 required by the GPS. Nor do we accept that the guiding
18 principles contained in the Rulebook meet this key aspect of
19 the GPS.

20 Having participated in the establishment process, I
21 believe it will be nigh on impossible to get the EGB to give
22 priority to addressing consumers' concerns as they come up.
23 The unpopulated part B is clear evidence of this. A supply
24 side dominated EGB gives a great deal of weight to the
25 gentailers' assets but gives scant regard to the consumers'
26 assets and investments that are at risk.

27 We've focused very much on having an EGB with executive
28 power. CC 93 has consistently said that the board must have a
29 mandate and the ability to make final decisions subject only
30 to a call through by members. You've been given a copy of the
31 proposal CC 93 put to the Establishment Committee, I think,
32 and I wasn't intending to go through that in detail, but we do
33 expect if you want to put questions on it.

34 Just quickly, we want the right to have at least two
35 representatives on every working group. It certainly is
36 difficult for consumers to participate in the process. There
37 are very few consumers with the necessary experience and
38 knowledge of how the industry works, but, through
39 participation working parties, we know we have been able to
40 bring good leadership and decision-making skills. We've had
41 members on each of the working parties and we had three people
42 on the Transmission Working Group I know in particular that
43 group, but where we had somebody entirely new to the area, but
44 again a farmer leader who has really put his, you know, mind
45 and time to the job; I know both the chairman of that group
46 and others on that group speak highly of the input they have
47 made.

48 It is our view that the all encompassing Rulebook is not
49 appropriate for the mix of voluntary, wholesale and spot
50 electricity market, obligatory meeting and reconciliatory

1 arrangements and mandatory common quality and security
2 arrangements. In our view the mandatory security issues are
3 not resolved by the quantum meruit approach. We end up with a
4 risk that consumers will bear the cost of the inability to
5 enforce mandatory security aspects, yet the consumer will have
6 no say over these rules.

7 **MS REBSTOCK:** Can I just interrupt you for a second. Consumers
8 have had quite a bit of input, I understand, in MACQS to date
9 and I wondered if you could give us some background on how you
10 perceive that working?

11 **MS PETRIE:** I personally can't. As I say, I'm sort of newer to
12 it. David, did you? No; okay, Terence?

13 **MR CURRIE:** CC 93 as such is not part of MACQS but there are
14 appointed representatives from the Consumers Institute and
15 MEUG, as well as the Chambers of Commerce from its inception.
16 Until quite recently the Consumers Institute rep was Judy
17 Jones, who's now become the Commissioner. I'm now the MEUG
18 representative on the Grid Security Committee. We have found
19 that arrangement, that ability to be part of the Grid Security
20 Committee determining the maximum and the common quality and
21 security issues as being an appropriate forum. We don't
22 always get our way, but we certainly ensure that we get a good
23 hearing.

24 So, the general reaction of consumers to the MACQS/Grid
25 Security Committee process is pretty -- is very positive.

26 **MS REBSTOCK:** The other question I really wanted to put to you
27 is, there's been some suggestion -- and you will be familiar
28 having been here for some of the discussion -- that often when
29 we think we're getting a consumer viewpoint, it's heavily
30 dominated by the major users and very hard to get a
31 representation from consumers. I'd like your comment on that.

32 You've found a way to find a coalition, so I assume
33 you've found a way to make sure the range of consumer
34 interests are represented. But, it would be helpful to hear
35 your response to some of the comments that have been made
36 throughout the hearing about, we're only getting one bit of
37 the consumer perspective often.

38 **MS PETRIE:** I'd like to make a comment, and I'm sure David will
39 make a comment as well. In replying, I'll sort of put on my
40 hat as not being the CC 93 representative, but somebody
41 representing a group of consumers from the rural area which is
42 both business, which is generally small, although often quite
43 considerable assets, and the domestic consumer.

44 I go back to the point I made before; it certainly is
45 very challenging to try to get a grip of the complexity of the
46 issues and to come up to speed. That's why I emphasise at
47 starting that we have been reliant on some of the knowledge
48 and the resource base that is there in the major electricity
49 users, but we as Federated Farmers, and certainly Consumers
50 Institute, have also had a long time of policy analysis and

1 policy development, and certainly we are alert to making sure
2 that we're constantly caucusing with the other parties with
3 regard to aspects or proposals. Personally, I've got to know
4 more about the whole area, have made the decision because I'm
5 actually in charge of the Federated Farmers whole Policy Unit
6 and, as a consequence, of understanding the challenges are to
7 meet it and serve our wide, you know, 17,000 members' needs.
8 So, I've increased the resources we're putting into this area
9 to expand it because, I agree, it is a challenge, but we all
10 come from our perspectives of who we have to represent and
11 it's through that mechanism, and a lot of long training I
12 suppose, that we've drawn upon.

13 **MR RUSSELL:** Really only to endorse, John, what Katherine has
14 already said: We've had a Policy Analyst one day a week.
15 Unfortunately, he has been poached by the Electricity Consumer
16 Complaints Commissioner and left last Friday, but
17 nevertheless, we definitely have had an input into the work
18 that's done. Yes, we do rely to a large extent on some of the
19 research that's done by the major users, but we still have had
20 an input on behalf of the small domestic consumer.

21 The issues aren't quite the same for the domestic
22 consumer as they are for the major user. So, some of the
23 stuff that's talked about is not of immediate concern, but the
24 implications are of concern to the domestic consumer, and
25 we've certainly played a part in that.

26 **MR WHITEHOUSE:** If I could just offer one other comment, perhaps
27 to put this to rest; the process that's dominated by major
28 users. I think it's worth pointing out that Business
29 New Zealand is a member of the Major Electricity Users Group,
30 but we come with a far broader church behind us. So, whilst
31 some people, it may suit their agenda to suggest that it's
32 only major electricity users involved, the practicality of the
33 matter is that that's not correct; our concerns, we're quite
34 comfortable, are reflected through our representatives.

35 **CHAIR:** I think that's probably the key point that I think you've
36 all answered. Through CC 93, I guess, without putting words
37 in people's mouth, the Commission can accept that basically
38 the issues that your members collectively are concerned about
39 are coming through, as I think in concept they're probably not
40 dissimilar from a user point of view. That's fine.

41 **MS PETRIE:** I think it might be useful to add just one other
42 point. It certainly has been a challenge to get the broader
43 masses engaged on this issue, say, compared to some others.
44 One of the reasons for that is that the initial Rulebook that
45 was taken out for consultation was deliberately narrowed down
46 to those sort of things considered immediate and necessary to
47 be able to apply for authorisation.

48 So, a lot of the issues for the ordinary consumer that
49 are clearly defined are actually issues that they aren't yet
50 dealing with. So, for all the best effort in the world to try

1 to summarise and get people engaged it wasn't sufficiently
2 immediate enough. But, for instance, if they went out with a
3 model distribution contract or model transmission contract, I
4 suggest you'd have, in terms of my constituents, the rooms
5 full.

6 **MR CURRIE:** One final observation; that really is that there is -
7 - there has to be a robust process of policy development
8 process. Given that CC 39 has participated in every inquiry,
9 every piece of legislation submitted, it is because we have
10 that robust debate, the very fact that it survived nine years,
11 I think, actually says that we do find an ability or a way of
12 ensuring that all the parties do feel that their particular
13 points of view come through in a collective way.

14 **CHAIR:** All right, let's proceed. I think it was very useful to
15 explain the background there and the involvement, I think,
16 from the Commission's point of view.

17 **MS PETRIE:** I just return now to some of the specific questions
18 that the Commission put. Clearly we don't have the resources
19 to respond in detail to your specific question, but I want to
20 comment on just three. One is, the questions relating to
21 Section 30. The other is the counterfactual, and the third is
22 the voting arrangements.

23 Quite simply -- and I don't think there's any point in
24 going through it, because you've seen our written submission -
25 - but we consider that all the pricing mechanisms fall within
26 the ambit of Section 30. That's the wholesale, transmission
27 costs, and the allocation. Our concern is that, once the
28 mechanism is authorised, it will be difficult to change.

29 There's currently less competition in the generation and
30 retail market now than needed, but at least under the current
31 arrangements aggrieved parties can turn to the Commerce
32 Commission, and this possibility is lost once the Rulebook is
33 authorised. Authorisation now risks locking in, we believe,
34 higher electricity prices at the same time the Rulebook limits
35 the EGB's ability to change rules relating to pricing and cost
36 allocation methodology.

37 With regard to the counterfactual: Now, I'm aware of
38 the discussions that you had with MEUG on this, we accept that
39 the Commission has accepted the right counterfactual. I was
40 present when your argument about the circular was put --
41 argument was put to Mr Currie. However, we remain of the view
42 that, if the application is declined, the Establishment
43 Committee would see its way to make some changes, which would
44 be likely to be more acceptable to CC 93.

45 I have to say philosophically my constituents, the
46 farmers, would prefer to have an industry-driven arrangement.
47 But if forced to choose between the proposed Rulebook and
48 voting structure and the Government EGB, we would choose the
49 latter. We put greater faith in our ability to influence the
50 Government EGB than we would be able to influence the proposed

1 arrangement.

2 **MS REBSTOCK:** Can I ask you a question in terms of your
3 constituency; I accept the qualification on what terms you
4 would prefer an industry EGB, but what is the reasons for
5 preferring an industry EGB for your constituents if your
6 concerns were addressed?

7 **MS PETRIE:** If they were addressed -- I mean, our constituents
8 basically like to see less Government in their life. That,
9 sort of, very much is the driving behind my particular, you
10 know, the rural constituents.

11 I think David should speak from the general consumer
12 point of view. We have discussed this.

13 **MR RUSSELL:** And not in the presence of MEUG.

14 **MS PETRIE:** We have the odd phone calls.

15 **CHAIR:** We've had all sorts of comments about collusional
16 behaviour; I doubt we can accuse you of that, David.

17 **MR RUSSELL:** I'm in agreement with what Katherine has said. It
18 is a policy position that the institute has developed over
19 recent years where if possible, we like to deal with industry.
20 In other words, if two consenting parties can get together and
21 sort things out on equal grounds, then that is the preferable
22 way forward for consumers. We believe that the best outcome
23 is going to come from that for consumers. Only if there is an
24 imbalance or if there is an inability to reach an agreement
25 between an industry and the consumer groupings would we then
26 turn to the Government. We believe that that imbalance is
27 apparent in the current.

28 **MS REBSTOCK:** Is that based on lower transaction costs or better
29 information, or...?

30 **MR RUSSELL:** Let me give you some examples. It's based on
31 empirical evidence of what has happened. If you look at the
32 Advertising Standards Authority, New Zealand is probably a
33 world leader in having relatively light-handed Government
34 interference. We have the Fair Trading Act, we have the
35 backstop of legislation there. But, in terms of the day-to-
36 day dealings in advertising, its operated by what I call a --
37 not self-regulation, but co-regulation between an agreement
38 between the advertising industry and the Newspaper Proprietors
39 Association and consumer groups developing codes of practice
40 which are then in operation.

41 It allows for -- indeed, I was talking about this with a
42 staff member only today -- the speed with which change can be
43 made. We are having a bit of a spat with our Australian
44 counterparts who are very strongly in favour of Government
45 intervention in advertising, particularly with therapeutic
46 products. We've had the experience here of being able to go
47 along with the NPA Newspaper Proprietors Association and say,
48 hey, we believe that this ad is misleading, here are our
49 grounds, and then within 24 hours having that ad withdrawn.

50 So, that's just to give you a little bit of the history

1 of why we've reached this view, if we can have a good
 2 relationship with an industry group and treat each other on
 3 equal terms and apply rules that are even-handed to both
 4 parties. That would be our preference, because it seems to be
 5 more reactive, quicker to react when reaction is needed than
 6 if you have a regulatory regime -- a Government controlled
 7 regulatory regime.

8 **MS REBSTOCK:** There's been some people -- or it's been suggested
 9 that some of what you would want to see in this proposal which
 10 would make it acceptable to you actually makes it in fact a
 11 regulated option. I mean, it no longer would actually be an
 12 industry led body. Do you accept that?

13 **MR RUSSELL:** You're absolutely right. That's because we don't
 14 believe, the way the rules are drafted at present, are going
 15 to provide the right outcome.

16 **MR CURRIE:** In a sense though, simply the act of authorisation
 17 gives it sort of a quasi regulated outcome in any event. It's
 18 not as though we're talking about a voluntary arrangement a-la
 19 NZEM where you can opt in. In a sense, having an authorised
 20 Rulebook where the comprehensive, if not total membership of
 21 say Part G of all electricity being traded through the one
 22 arrangement, that does seem to me to make the distinction
 23 between a regulated and a non-regulated outcome as being
 24 almost one of semantics.

25 **CHAIR:** Not quite; I mean, it protects it from attack. It's
 26 still over to the parties to join it, but it protects people
 27 attacking it for being exclusive. It doesn't, as it were,
 28 endorse the, if you like, the philosophy per se if we approved
 29 it -- I'm only postulating -- it simply says that, if they
 30 make mandatory participation, then it can't be attacked under
 31 this Act. It doesn't per se say that mandatory or not
 32 mandatory is a good thing.

33 **MR CURRIE:** No, I agree, it doesn't address the philosophy or
 34 doesn't address the detail, but I'm just thinking in a
 35 practical sense, in a way, the act of authorisation does give
 36 it -- even that immunity is a form of regulated immunity by
 37 way of authorisation. That's really, but....

38 **CHAIR:** Fair point. Ms Petrie, please.

39 **MS PETRIE:** I'm just reflecting on the comment. I mean, I think
 40 I agree, yes, it is a regulation and it's sort of regulation
 41 in a way that the rural sector has been quite familiar with,
 42 admittedly being pulled apart, but the statutory board process
 43 where in fact entities have been given leadership roles with
 44 varying degrees of powers, quite limited or quite narrow.

45 But again, sort of the direction the priorities set and
 46 the strategic direction has been set by the industry with the
 47 people who are paying for those being given some very strong
 48 rights to make sure their interests are protected. That's
 49 where a lot of the evolution has been getting those better and
 50 more transparent.

1 I think there's a huge difference between the structure
2 that's being envisaged here for the proposal and those sort of
3 arrangements historically; quite surprising. I suppose I
4 should go back and say, why would my constituents, I mean even
5 though some of the younger up-and-coming farmers now, it's
6 almost as if they've been born with knowing what life was like
7 before 1984 and afterwards. Even now they speak absolutely
8 strongly and utterly about the disaster, and the resource
9 misallocation that occurred when so much of activity was being
10 directed by Government. So, they tend to bring that
11 philosophy to everywhere and only inviting regulation where
12 it's quite clear the market -- or you've got monopoly
13 arrangements that require a greater control or transparency.

14 **CHAIR:** Would that be a view shared by Business New Zealand?

15 **MR WHITEHOUSE:** Yes, indeed, I think so. In fact, I admire
16 Katherine for her moderate language in regard to this. Our
17 view would be entirely that, if the Rulebook etc was to go
18 through as it is now, our default most definitely would have
19 to be a regulated EGB. Our reasons would be very similar to
20 Federated Farmers. We don't like, sort of what we might term
21 the leaden hand of Government; that would be a concern. But
22 that is counterweighted by the fact that we believe the
23 current application that we're dealing with here completely
24 shuts out, in our view, any practical consumer participation
25 and also -- without going into it now -- has got, we believe,
26 anti-competitive aspects to it.

27 **MS PETRIE:** The third area that I said we'd talk on; voting
28 arrangements. Your questions 9 to 14 highlight our concerns.
29 CC 93 considers that the Commission should not authorise a
30 Rulebook that does not provide consumers with any say in rule-
31 making and rule changing process.

32 I sat through many discussions where the gentailers
33 argued that they would strongly oppose consumers having a say
34 over their assets. Scant regard was given to the consumers'
35 assets that are either directly or indirectly put at risk. I
36 won't bore you to death, but I have so many instances where
37 farmers have faced quite considerable costs. The Rulebook
38 remains supply side dominated and any decision of the EGB can
39 be overturned through this dominance.

40 **MS REBSTOCK:** Can I just ask you a question on that. I mean,
41 we've focused on this comment -- Meridian probably -- which
42 is, they'd never made it perhaps because we'd focused on it to
43 a great degree, not that they've stood away from it; I don't
44 want to give you that impression.

45 But, I was yesterday reminded -- or Transpower's
46 economic advisors reminded me of discussions we've had in
47 other network industries, and made me recall that when we
48 talked about coming up with some industry codes in another
49 industry, consumers were reasonably welcome at the table, but
50 the industry players were most concerned about being forced to

1 sit down with their competitors and let their competitors have
2 a say in their operations and control over their assets. Not
3 using those words but, in effect, that's what they were
4 saying.

5 I've thought about this a bit and wondered why it is in
6 this industry; the industry seems to be happy to let their
7 competitors have a vote and say on these very things, but not
8 consumers. So, I would just invite your comment on why you
9 think that is. It troubles me slightly when I think about it;
10 the more I've thought about it overnight, the more I'm
11 troubled about this. Why is there not objection to their own
12 competitors having this input?

13 **MS PETRIE:** Because there's pretty little competition.

14 **MR RUSSELL:** The structure of the industry I think; presumably
15 you're talking about telecommunications?

16 **MS REBSTOCK:** (Nods).

17 **MR RUSSELL:** The circumstances are quite different between the
18 two where you have that one dominant provider of a service
19 with considerable control where, with the electricity
20 industry, through a series of moves, you have split that up;
21 the splitting of line and energy for example. We haven't had
22 that in telecommunications, it's still in -- most areas in
23 New Zealand have the one dominant company that has control
24 over the distribution network as well.

25 **MS REBSTOCK:** You see, I would have thought that that would have
26 actually meant there'd be even less comfort in this industry
27 about sitting down with your competitors and giving them
28 voting rights over things that directly affect your business.
29 I'm not quite sure I understand why, in this industry, it's --
30 I would have expected just the opposite result, that the
31 greater competition here would have meant they'd be more
32 nervous about their competitors having a say in what happens
33 to their operations and their assets.

34 **MR RUSSELL:** I think any further comment I make would be pure
35 conjecture, but you have posed a question; it's really
36 interesting.

37 **MR CURRIE:** I'm not too sure whether they are necessarily that
38 sanguine about that process, but it is just better than giving
39 consumers or other parties a say. So, there may be a bit of -
40 - they can ride through or they can work together. The number
41 of times that the CEOs of the industry seem to get together
42 and talk about issues which I would have thought were
43 bordering on competition policy issues, always never ceases to
44 amaze me.

45 Sometimes I understand they have the sanctity, or they
46 sanctify their process by inviting someone along from the
47 Minister's office or from the MED. But nevertheless, it does
48 surprise me.

49 You having raised the point, I will think now and think
50 whether there are any substantive reasons why they feel more

1 relaxed about having their competitors make decisions rather
2 than their customers or their suppliers, or their service
3 providers, because they are not particularly relaxed in their
4 dealings with Transpower. They're not that relaxed in their
5 dealings with the line companies. But, among a small group,
6 you know, a coterie of four or five generators, they seem to
7 be relatively relaxed in working together on that basis. But,
8 I will certainly reflect on it.

9 **MS BATES:** You've said that, if it came to a choice between this
10 proposal as it is and the counterfactual, you'd prefer the
11 counterfactual. I don't know if you were here when --
12 Transpower advances a likely counterfactual, a Crown EGB with
13 Part F and its voting structure more or less in place. Now,
14 if that were the -- and they were asked whether they
15 considered consumers should be given voting rights under
16 Part F; no, they did not. So, I'm just wondering whether
17 you'd thought of the possibility that the counterfactual may
18 not put you in a better position?

19 **MS PETRIE:** I wasn't there in Transpower's -- I suspect, if
20 Part F were like that, without consumers say, we wouldn't be
21 comfortable. But again, I'd probably go back to what I said
22 before, that we would perhaps think we'd have a reasonable
23 chance of preventing that through the political process. I
24 mean, the areas of transmission and distribution are the ones
25 that are very important to consumers. It's the one where
26 there's a very poor transparency.

27 **MS BATES:** Yes.

28 **MS PETRIE:** And it's the area where, right now, as there are
29 other processes going on again stretching our resources, but
30 the pricing policy that Transpower's currently working on and
31 your own work in the distribution.

32 **MS BATES:** You might have heard that other people consider
33 Transpower to be a most effective lobbyist. Do you agree with
34 that assessment?

35 **MS PETRIE:** Yes, indeed. How to phrase this; the most recent
36 Bill had quite outrageously, in our view, had introduced a
37 phrase whereby they were just going to put into law that all
38 assets that were on land were legally applied to the land.
39 Now, that required massive lobbying effort on our part against
40 Transpower's interests, because it was Transpower's interests
41 that got that in there and, to put it crudely, we won; they
42 lost.

43 **MS BATES:** So, you're an effective lobbyist too?

44 **MS PETRIE:** Well, that's what we are, a policy agent representing
45 the rural consumers. So, that's why I say, if I had to
46 choose, because you have an ability to draw upon the broader
47 political concerns and concepts of sort of Bill of Rights and
48 Magna Carter in the Parliamentary process, you don't have that
49 with an industry arrangement with authorisation that, you
50 know, you can lobby to your heart's content, but when it comes

1 down to it you don't have the same democratic voting processes
2 that you do with the Parliamentary process.

3 **MS BATES:** Though --

4 **MR CURRIE:** Generally I think, just in response to your question,
5 Commissioner Bates, we're not that unhappy about Part F. I
6 think we've already indicated that it was probably one of the
7 more positive things which came out of the process and the 75%
8 threshold to make a decision in terms of progressing forward
9 on an investment and the process set out to approve the
10 pricing methodology.

11 So, we're not a -- we support in broad terms Part F.
12 But I think that to turn around and say that you would prefer
13 a Crown EGB plus Part F sort of falls into the cherry picking
14 sort of category where you're starting to devise or say this
15 is what I'd like and these have to be the essential elements
16 of the counterfactual.

17 So, it's totally appropriate for Transpower to make
18 that, you know, they would like to see a Crown EGB with
19 Part F. But I'm not too sure whether it's like us saying we'd
20 like an industry EGB but we want to have X, Y, Z and A, B and
21 C all made into that industry EGB and then we would give it a
22 tick.

23 **MS PETRIE:** Your proposition was with no consumer say over
24 Part F?

25 **MS BATES:** Yes.

26 **MS PETRIE:** Certainly we've had, as a consumer rep and a farmer
27 on that working group, have had considerable input into that
28 because we have very deep concerns about that aspect.

29 **MS BATES:** So you think Part F should have consumer voting?

30 **MS PETRIE:** Our whole proposition was that you didn't have
31 chapter by chapter voting.

32 **MS REBSTOCK:** Can I just come back to the question I put to you
33 before. I just want to clarify that. I was not suggesting
34 there was collusion within the industry. It was more if
35 there's such an alignment of interest, why is that in this
36 particular industry and so I just want to make sure that my
37 question was not mistaken.

38 **MS PETRIE:** I thought a little bit more about your question and
39 its totally supposition, but very early in my sort of
40 participating in this process I was sort of intrigued by these
41 amazingly detailed rules that, you know, for every little
42 aspect. I don't know why telecommunications is different,
43 although certainly as consumers we haven't had the effect of
44 uniting in the telecommunications as we have had in
45 electricity.

46 My belief is that the rules have been done in such a way
47 that the balance, the fine balance there is at exact -- what
48 they see in the strength of it is the same thing as we're
49 seeing the problem. It is very difficult for anybody to
50 influence one way or the other, you know, and the working

1 parties can be very very long and difficult, but sometimes
2 they do collectively decide it's actually in all their
3 interests to change it a certain way. But it would seem to be
4 the strength of the rules base system as well as for our point
5 of view part of the weakness for it.

6 **MR RUSSELL:** Can I perhaps put forward an underlying
7 proposition. The industry is dominated by the fraternity of
8 engineers. They have been good mates in the past. They have
9 worked together very closely in the past. They have a history
10 of cooperation and the competitive market is something that
11 has been imposed upon them. I don't know. That's a thought.

12 **MR CURRIE:** Just one little observation, just an additional
13 anecdote type comment, so many of them all came out from a
14 career within ECNZ. There is sort of an collegiate, even
15 though they are competitors. The industry -- I wouldn't
16 describe it as incestuous, but there is certainly a strong
17 familiarity between some of the major players who have all had
18 senior roles within a single enterprise predisaggregation.

19 **CHAIR:** I think we'll note your comments on that.

20 **MS REBSTOCK:** The other question I wanted to ask you is there's
21 been a lot of discussion about the Government Policy Statement
22 and the alignment or otherwise of the principles in their
23 proposal in the GPS. First of all I'd like to know what your
24 view is on that generally as CC 93, but in addition it's been
25 suggested that the guiding principles should -- the Government
26 Policy Statement should actually form part of the Rulebook.

27 I have a question about the practicality of that given
28 the GPS is something that I think is likely to have changed
29 from year to year, or could change. The Government presumably
30 will update it and revise it as it goes along. So, I have an
31 additional question. Even if it was desirable to make it part
32 of the Rulebook itself, is that practical given the likelihood
33 that the Government will want to vary it over time?

34 **MS PETRIE:** I think I have to speak with a personal view because
35 I haven't had a chance to discuss this with David. I
36 certainly heard your conversation with Terence. I understand
37 that problem because it's one where in another context so
38 often Government Departments with regulatory roles lobby very
39 hard to have broad, umbrella legislation and get as much as
40 possible into regulation, or even more, as is the MAF model,
41 at tertiary level so that they can change these things easily.
42 Certainly I was very much part of the conversation and
43 listened to the debate around the table when arguments being
44 put for picking up the GPS straight or having something which
45 was more robust from their point of view in economic principle
46 type terminology.

47 I guess from my point of view the problem for whoever
48 comes in as the EGB, and the structure that is proposed where
49 they don't have decision-making roles, that they get close to
50 being put in a very difficult and very impossible position

1 very quickly, in that they -- it's difficult to direct, the
 2 changes or decisions are done sort of voting through the
 3 Rulebook, and you have a Government setting a GPS which may
 4 not necessarily align.

5 So, I think on balance in that environment if indeed
 6 you're not going to have executive powers of the EGB, you've
 7 got to have them aligned. That's the way I sort of feel about
 8 it because there are aspects of priority that the Government
 9 is trying to seek in setting its GPS which are not the same
 10 sort of priorities for the industry.

11 **MR RUSSELL:** I agree. I think there has to be an alignment.
 12 There needs to be an alignment. There's going to be confusion
 13 if there's not alignment. I just look at the heading "guiding
 14 principles". Surely this is what we should be starting with,
 15 this is where we should be going and they need to be aligned
 16 with the Rulebook or included in the Rulebook.

17 **MS REBSTOCK:** What happens over time when the GPS changes?

18 **MR RUSSELL:** One would sincerely hope that you would have a
 19 system in place that could accommodate that, so you would have
 20 to turn to the Rulebook and ensure that at all times there was
 21 that degree of alignment. The guiding principles are so
 22 general at the moment they are exactly that, guiding
 23 principles. I don't envisage that there would be a need or a
 24 will even on the part of the politicians to change those
 25 guiding principles in the near future.

26 **MR CURRIE:** It would be very unusual in the foreseeable future,
 27 it would be unusual, or slightly strange, for a Government
 28 who's produced a policy statement with the overall objective
 29 of the delivery of electricity in an efficient, fair, reliable
 30 and a sustainably viable manner for all classes of consumers
 31 that there would be an unusual situation where there was a
 32 significant variation or an unscrambling of that as a primary
 33 objective.

34 So, for at least the foreseeable feature, one would
 35 imagine, admittedly that's speculation on my part, that the
 36 primary objective, that touchstone will be there as a
 37 cornerstone of Government policy. It is clear that there will
 38 be changes in the detail, changes in, you know, in aspects of
 39 the GPS, but it would be, you know, it's a bit hard to
 40 immediately conceive of a Government resiling or stepping back
 41 from that primary objective.

42 **CHAIR:** One would expect that in negotiating or determining the
 43 formal standards for the industry EGB to be assessed by the
 44 Auditor General, there would be a fairly close look taken
 45 between the alignment between the GPS and the guiding
 46 principles.

47 **MR CURRIE:** Yes, one would assume that the -- if the Crown EGB
 48 was going to have a --

49 **CHAIR:** Industry EGB we're talking about.

50 **MR CURRIE:** Yeah, I know, I was just thinking, the primary

1 objective for a Crown EGB would be overall that primary
2 objective. For an industry EGB, for it to be audited or to be
3 checked against the performance standards by those two
4 Parliamentary bodies, I would think they're going to have to
5 audit them against that same primary objective.

6 **CHAIR:** But I mean in negotiating a performance standard with a
7 Minister for the industry EGB, the Minister and his advisors,
8 or her advisors, will have to make a judgment as to the
9 alignment of the guiding principles with the GPS at that time.

10 **MR CURRIE:** Yes, I agree.

11 **CHAIR:** That to some degree is going to be a discipline on
12 whatever the final product is, whether we approve it or not.

13 **MR CURRIE:** Yes, I appreciate that, but it does seem to me as
14 we've already canvassed, if you had as the primary objective
15 that overall policy objective, one would assume that there was
16 a constant pressure on the industry EGB or any institution to
17 be constantly looking to, you know, downward pressure on
18 prices. Not competition for competition's sake, but
19 competition as welfare enhancing or enhancing the welfare of
20 consumers. So, therefore I would have said that primary
21 objective does need to become that touchstone or cornerstone
22 of the process.

23 **CHAIR:** I just make the observation that, as I say, whatever this
24 Commission does in relation to the application, if either
25 structure proceeds they would have to convince the Minister or
26 Ministers every two years in conjunction with the GPS.
27 Anyway, just leave it on the table I guess.

28 **MS PETRIE:** I think we've sort of covered the -- where we're
29 going to head. Basically we are -- we do want the preliminary
30 view of the Commission to stand. There was just a --

31 **MR CURRIE:** There were two minor items I just wanted to cover.
32 That was an apology to the Commission on behalf of CC 93. We
33 did in our submission dated 22nd of May suggest that the main
34 area of concern you had was the voting and the potential
35 ability for strike down or delay of pro-competitive rules.
36 But clearly as we've read, debated, thought about the overall
37 Draft Determination we've accepted that that was probably a
38 too narrow a comment.

39 **CHAIR:** Thank you for that, because a lot of thought went into
40 that Draft Determination on the part of the staff as much as
41 the Commission, so thanks for that comment.

42 **MR CURRIE:** The second point was, in the tail end of our
43 submission, we observe that we weren't aware of any conditions
44 which had been imposed under a Section 58 type hearing but
45 since we wrote that we came to -- we've discovered the Kiwi-
46 fruit case, so really those are just two --

47 **CHAIR:** Thank you very much for A coming to talk to us and B
48 being willing to answer questions, which is very important,
49 and thanks for being flexible in terms of the timetable. So,
50 we will adjourn and reconvene tomorrow and Transpower will be

1 on at 1.00 o'clock and NZEM on Friday. Transpower tomorrow.
2 So, thank you very much.
3

4 **Hearing adjourned at 5.50 pm to 1.00 pm**
5 **on Thursday 27 June 2002**
6

7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45
46
47
48
49
50