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Regulation Branch
Commerce Commission
Wellington

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Setting Transpower's individual price-quality path for 2015-2020

1. Vector welcomes the opportunity to make a submission to the Commerce Commission (Commission) on its consultation paper, *Setting Transpower's individual price-quality path* (the paper), dated 16 May 2014. No part of Vector's submission is confidential.

Treatment of expected efficiency gains

2. The Commission proposes to set prices based on (among other things) a corporate opex forecast that is \$48.8 million lower than Transpower has proposed. The reason for the reduction is an expectation that Transpower can (or at least should be able to) reduce opex over the RCP2 period. The Commission and its consultants do not appear to have been able to identify any particular inefficiencies that could be removed but is generally assuming that something can be cut.
3. In general, there is always scope for regulated suppliers (like other firms) to look for efficiencies. The intent of CPI-X regulation is to provide meaningful incentives for suppliers to achieve efficiency gains, benefitting from those efficiencies over the regulatory period and sharing them with consumers at the subsequent reset. Instead the Commission appears to be implementing an approach in which the incentive to achieve efficiency gains is that, if they are achieved, then a normal return can be realised. This is unlikely to be in the long term interests of consumers as it creates a situation where suppliers have an expectation of earning less than a normal return over a regulatory period unless they can achieve efficiency gains, which are inherently uncertain.
4. The Commission's proposal appears to share efficiency gains with consumers before those efficiency gains can or have been identified by Transpower (or the

Commission). We do not believe this would be appropriate or consistent with the principles underpinning price-quality regulation.

Appropriate VoLL value for quality standards

5. For the purposes of setting Transpower's quality incentive rate the Commission proposes to use a value of lost load (VoLL) of \$20,000/MWh. The Commission has not provided explanation for why this is the most appropriate VoLL estimate to use for the purposes of setting Transpower's revenue-linked quality incentive.
6. It is likely that the Commission chose the default VoLL value set out in the Electricity Industry Participation Code 2010,¹ which is based on studies undertaken in 1992 and 2004. It is worth noting that while \$20,000/MWh is considered the default VoLL under the Code, it does not necessarily follow that it must be the VoLL estimate applied for areas outside of the Code.²
7. Recently, the Electricity Authority (Authority) completed a study on VoLL which produced a national VoLL estimate of \$50,031/MWh.³ This value more closely aligns with the Australian Energy Regulator's estimated value of customer reliability of AUS\$47,850/MWh (as at November 2009). When adjusted for inflation and converted into New Zealand dollars (on 19 June 2014), this figure converts to NZ\$58,226.53, which is reassuringly close to the Authority's estimate.
8. We consider that the default VoLL under the Code is out of date and in light of the Authority's recent findings is no longer a reliable representative of the value of unserved energy in New Zealand. Vector **recommends** the Commission reconsider what the most appropriate VoLL value would be for the purposes of its Transpower IPP determination, and consider using the Authority's national VoLL estimate of \$50,031/MWh.

Wash up for pass-through and recoverable costs

9. Vector supports a wash-up mechanism for Transpower's pass-through and recoverable costs. Like distributors, we consider that Transpower should be able to fully recover these costs (and no more than these costs) as there is no valuable

¹ Clause 4 of Schedule 12.2, Electricity Industry Participation Code 2010.

² *Investigation into the Value of Lost Load in New Zealand: Report on methodology and key findings*, Electricity Authority (23 July 2013).

³ *Ibid*, n 2, paragraph C.39. The \$50,031/MWh VoLL is based on a mean load-weighted for an 8 hour outage at the worst possible time for consumers – it is worth noting that longer outages have lower \$/MWh costs as the cost of restoration is spread across a higher quantity of MWh. The 2013 study concluded that single VoLL figure was an inappropriate measure of the value that consumers place on unserved energy. However, estimations of national VoLL figures to enable a comparison with the Code's current VoLL figure.

incentive for suppliers to be subject to cost recovery risk in relation to costs outside of their control and which they are unable to manage.

Contact details

10. If you require any further information, please contact me on 09 9788277 or Ian.Ferguson@vector.co.nz.

Yours sincerely,

A handwritten signature in blue ink that reads "I. Ferguson". The signature is written in a cursive, flowing style.

Ian Ferguson
Regulatory Policy Manager