

[Commencing at 1.04 pm]

**PRESENTATION BY TRANSPOWER [continued]**

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5 **CHAIR:** All right, well 1.00 o'clock having just gone, welcome  
6 people back to the hearing and we'll recommence. Just to  
7 recap what we hope to do today; we've got Transpower down from  
8 1.00 to 4.00 and presumably we can go a little past that if we  
9 have to, I'm just not sure. Tomorrow we have scheduled NZEM  
10 at 10.30 and Transpower -- sorry the applicant from 11.30.  
11 So, we'll try and work reasonably within those constraints.  
12 We'll need to take a break some time this afternoon, but we'll  
13 do that when time seems appropriate.

14 Secondly Transpower has submitted a paper summarising  
15 the submission I think they're looking to add to this  
16 afternoon on under-investment. Just before I ask them to  
17 speak to that, I'll ask Nathan Strong, who's our economist,  
18 just to pick up a couple of questions from yesterday I think.  
19 Nathan please.

20 **MR STRONG:** The question that I want to ask relates to benefits  
21 and detriments. I'm just flagging it now so we can sort of  
22 expedite the questioning at the end on this, since it's a  
23 relatively technical matter, you may want to take some time to  
24 consider it. I'm not expecting you to answer it right now. I  
25 just want to put the question in front of you.

26 The question relates to how differences in productivity  
27 in the wholesale electricity market should be measured. It's  
28 with respect to the quantification of dynamic efficiencies in  
29 that market and in particular what we should use as the  
30 appropriate measurement base.

31 The Draft Determination argued that because differences  
32 in the rules would affect the manner in which equipment could  
33 be operated and the way in which it would be dispatched, it  
34 would be appropriate to apply any difference in productivity  
35 to the entire variable production cost curve and we used a  
36 number of 920 million there.

37 NZIER's submission was that any difference in  
38 productivity should be applied to a subset of these variable  
39 production costs which you termed "common goods" and took it  
40 down to a \$92 million value. The applicant, I think, endorsed  
41 the Commission's preliminary view that rules would affect the  
42 manner in which equipment is operated and dispatched, but  
43 argues that the appropriate base to apply any difference in  
44 productivity to should be the market value of additional  
45 output since this reflects the value that consumers place on  
46 additional output and they used a base there of 1.8 billion.  
47 So we're talking about a spectrum of 92 million to 1.8  
48 billion, so I it's clearly necessary to get this right.

49 Two questions that I want to put to you is, do you agree  
50 or disagree that if the Commission found that differences in

**Transpower (cont)**

1 the rules led to differences in the manner in which generation  
2 equipment was operated and dispatched, that this should apply  
3 to the entire variable cost or value base rather than the  
4 common costs you suggest, and secondly is it appropriate to  
5 use a production cost base for examining differences in  
6 productivity, or a market value base for the effects of  
7 differences in productivity.

8 I just wonder if you could frame your arguments with  
9 respect to changes in consumer and producer surplus, that  
10 would be helpful. If you want to use some sort of diagram,  
11 that would be useful, but, you know, answer it in any way you  
12 see fit. It's a bit of a long winded question and I have it  
13 written down verbatim for you, so I can provide that to you if  
14 you like. Over to you.

15 **DR SUNDAKOV:** I think that's fine. Given that it's a rule beyond  
16 for the remainder of the presentation, I think we'll try to  
17 address it. But if we have a chance to put some thoughts down  
18 on paper later, I'm not sure we'll have enough time to really  
19 think this through.

20 **CHAIR:** Thanks Mr Sundakov. Ms Callinan, back to you please.

21 **MS CALLINAN:** Thank you Mr Chair. I thought that I would just  
22 give an indication of the order in which we thought it would  
23 be sensible to address the issues this afternoon. We'll start  
24 with answering some questions that were left on the table  
25 yesterday and then I will give a brief recap on our  
26 submissions on under-investment, and you'll see there's a one  
27 page that we've done overnight on that.

28 Then we'll hand over to Mr Sundakov to deal with over-  
29 investment and contestability of services, and then come back  
30 to a part of the submission that we skipped over on anti-  
31 competitive rules and deal with, in that section, the  
32 constraints on the industry EGB. After that we would hand  
33 back over to Mr Sundakov to talk to the paper that he's  
34 prepared on market power. After that we'll pretty well follow  
35 the order of the submissions as in the index.

36 **CHAIR:** That's fine, thanks.

37 **MR ROBERTSON:** Specifically there were two questions that I think  
38 we had left open. One of which related to a request that we  
39 give some ballpark estimate of the cost of implementing the  
40 character of grid that we believed should evolve, other things  
41 being equal. I yesterday estimated it at significantly above  
42 500 million. I guess in that context I'm happy to report that  
43 the estimate that I bring back today is that the cost we  
44 estimate would be approximately \$1 billion spread over the  
45 next 20 years.

46 I just list the sort of key assumptions that underpin  
47 that. I'm not sure to what extent these are relevant for you,  
48 but we've assumed -- remembering that was in the context of an  
49 analysis which suggested that overall our view is that demand  
50 will rise over the next 15 -- through till 2020 to such an

**Transpower (cont)**

1 extent that it will out-strip the capacity of the existing  
2 core grid to satisfy that demand which would either suggest  
3 the need for new line routes at a 220 KV level or the  
4 preferred alternative, in our view, the most cost-effective  
5 alternative to be to upgrade the existing 220 KV line routes  
6 to 330 KV.

7 The assumptions we've made are that the existing 220 KV  
8 line lengths and routes can be used. Only those 220 KV line  
9 routes essential to be converted by 2020 to meet our estimate  
10 of the demand are included in the cost. There may be some  
11 additional need for conversion post 2020, but we haven't  
12 included that. It's assumed that some of the structures and  
13 equipment currently in place would be re-useable, if you like,  
14 in that upgrade and we've developed this estimate of cost sort  
15 of by rule of thumb, if you like, so X kilometres of line at  
16 330 would normally cost so much.

17 There are some benefits that would flow as a result of  
18 that upgrade. I'm not sure whether you're interested in the  
19 sort of significance of those. But our demand forecast upon  
20 which this is based is a peak demand of 9,050 megawatt. By  
21 upgrading to 330 KV on the core 220 KV network, transmission  
22 losses are estimated to reduce by 150 megawatts. We estimate  
23 an avoided operating cost of \$20 million per annum and  
24 additionally operating at 330 KV would avoid the need for  
25 1,000 meg of hour of additional reactive power compensation.  
26 We've estimated the cost of acquiring that reactive power at  
27 50 million, so it would be a saving of 50 million.

28 **MR CURTIN:** Thank you very much, we're just trying to get some  
29 feel when we're plugging numbers in for what dynamic  
30 efficiencies might or might not be if there was a way to  
31 unlock unnecessary investment that doesn't exist today, so  
32 thank you for that.

33 **MR ROBERTSON:** Okay. The second question I think related to  
34 asset write-offs.

35 **MR TAYLOR:** That was ODV write-offs.

36 **MR ROBERTSON:** ODV write-off in respect of investment which had  
37 been undertaken on the basis of security, against a security  
38 justification. That's more difficult to get any sort of  
39 precise number on, because once an asset is commissioned it  
40 doesn't carry in our system a tag as to whether it was  
41 commissioned on the basis of a service change justification,  
42 or a service integrity, or i.e. Security justification.

43 But I've got some numbers that may help. I think they  
44 confirm the off-the-cuff reaction I had yesterday to the  
45 question that there was nothing significant that jumped out at  
46 us, certainly not in respect of investments that have taken  
47 place in the recent past, the last five to seven years.

48 The source of write-offs we touched on briefly  
49 yesterday, but when we commission new assets, there may be  
50 write-off in relation to assets that are now being replaced,

**Transpower (cont)**

1 so the assets that are currently in the ground may not be  
2 usable as part of that project so there will be a write-off  
3 there. Then there are write-offs that occur, that I talked  
4 about yesterday, arising from differences between the project  
5 costs and the ODV building block costs. Do you want me to go  
6 into -- no.

7 Then finally there are the write-offs that flow after  
8 the assets have been commissioned as a result of changes in  
9 modern equivalent assets, changes in asset prices, or changes  
10 in the optimised configuration of the assets. I sort of had  
11 the feeling you were focused on that latter point.

12 **MR TAYLOR:** I accept the point that you made. The generality  
13 was, there was no substantial -- nothing of substance.

14 **MR ROBERTSON:** Okay. Just rounding it off then, what we did was  
15 look at 14 approved business cases that totalled \$18 million  
16 and the write-off that flowed from that related solely to the  
17 differences between the project costs and the ODV building  
18 block costs, and it was only \$1 million. So 1 million on 18  
19 million.

20 **MR TAYLOR:** 1/18th.

21 **MR ROBERTSON:** Yes 1/18th. I also then asked what's our  
22 experience been over the last three years in relation to re-  
23 valuations arising specifically as a result of optimisation,  
24 so changes in configuration of the grid reflecting changes in  
25 demand patterns and so on. Over the last three years a bit of  
26 up and down there, but the net write-off has been \$49 million  
27 on an asset base of around roughly \$2 billion. That's  
28 cumulative over three years.

29 **MR TAYLOR:** Thank you for that.

30 **MR THOMSON:** Could I -- I know we're trying to get through  
31 things, but what we've actually done is we've increased the  
32 end capacity, the bilateral contracts with the customers ahead  
33 of load growth, just a wee bit. We've got a wee bit more  
34 capacity now than we would have had in say 1990. But in the  
35 core grid where there's multilateral things, we've been doing  
36 a lot of maintenance and a lot of quick fixes to up the  
37 capacity. You can only do that for a certain amount of time,  
38 right. Probably in about five, four years, three years we'll  
39 run out of that. That's when we've got to start and go to  
40 this 330.

41 **MS CALLINAN:** We thought at this stage we'd just move on to a  
42 very brief summary of where we got to on under-investment  
43 before we move on to the topic of over-investment in the grid.

44 The Commerce Commission has heard from a range of  
45 submitters that there is currently under-investment in the  
46 grid and in respect of -- in that respect the Commission has  
47 drawn a distinction between under-investment for security and  
48 where there has been inadequate investment for capacity, or  
49 less than optimal investment in that regard.

50 Transpower points out that investment and capacity if

**Transpower (cont)**

1 not undertaken will become investment needed for security.  
2 That's the status quo and under the status quo Transpower is  
3 both the final decision-maker on investment in the grid,  
4 although it does consult with stake-holders before investing  
5 and it tries to get agreement and it is of course as the grid  
6 owner the party which implements the decision to invest.  
7 That's a distinction we thought it was important to emphasise  
8 for reasons I'll go on to explain.

9 The GPS identifies certain principles for the provision  
10 of transmission services, principles which would apply to both  
11 the industry board and the Crown EGB. These include system  
12 expansion and replacement principles, and specifically those  
13 include the following principle, which I will read out.

14 "In addition to those circumstances where Transpower and  
15 the grid users have voluntarily agreed, grid expansion and  
16 replacement should take place where the Governance Board is  
17 satisfied the costs of rising from, A grid restraints, and B  
18 the risks relating to security, exceed the costs of relieving  
19 those constraints and risks through investment in the grid and  
20 alternative responses by industry participants and/or grid  
21 users such as distributed generation and demand side  
22 management are not and are unlikely to be adequate to resolve  
23 the issue.

24 Therefore the significance of this part of the GPS is  
25 that mandate's a shift from the status quo where in the  
26 absence of agreement Transpower is the decision maker to  
27 where the Crown or the industry EGB is the final decision-  
28 maker on investment, in the event of failure of market style  
29 arrangements. In accordance with the GPS we expect that  
30 Transpower will still implement any new investment in the grid  
31 where that is sanctioned by one or other of the EGBs."

32 Just taking that and then focusing on the proposal, the  
33 arrangement under Part F improves upon the status quo,  
34 Transpower acknowledges that, to the extent that the voting  
35 system may lead to coalitions to support investment and that  
36 may happen in many cases. But as Transpower tried to  
37 illustrate yesterday with the example in Auckland given by  
38 Mr Heaps, there will be hard cases where voting coalitions  
39 will not always form and where the large cost of an  
40 investment, 300 million in the case of Auckland, will  
41 incentivise participants to use brinkmanship(?) and to try to  
42 shift the costs on to others. In the proposal Part F does  
43 provide an appeal right to the EGB in that case. However, the  
44 right can only be exercised in such limited circumstances that  
45 there is a serious risk that the industry EGB will not be  
46 empowered by the rules to make a final decision on investment.

47 On that point Transpower does see a divergence between  
48 the Rulebook and what is mandated in the GPS. Put simply then  
49 the problem that Transpower sees with Part F is that no-one  
50 may be left accountable for making a final decision on whether

**Transpower (cont)**

1 the investment should proceed. Transpower is not accountable  
 2 for that decision under the arrangement, because the whole  
 3 thrust of Part F is to devolve that accountability to the  
 4 industry.

5 Nor should Transpower step in, because this is not what  
 6 the GPS has mandated. This is the critical distinction  
 7 between the status quo and what would happen under the  
 8 proposal or the counterfactual. Given that there is, in our  
 9 submission, a significant risk of under-investment, and you've  
 10 just heard what Peter Robertson has said about the figures,  
 11 this needs to be measured in the context of that evidence;  
 12 that estimates of capital expenditure on the grid over the  
 13 next 15 years are in the region of \$1 billion.

14 The safety net in the proposal is that under-investment  
 15 is picked up in the first instance by the Auditor-General.  
 16 Even if the investment decision is relatively clear-cut, there  
 17 are likely to be complex issues around timing. Transpower  
 18 says, for example, that resource consents in the Auckland  
 19 project should be sought in 2003. We query how the Auditor-  
 20 General would resolve disputes over this type of issue. We  
 21 say that triggering a legislated solution in response to this  
 22 kind of failure is a blunt instrument to deal with the  
 23 problem.

24 This contrasts with the counterfactual which Transpower  
 25 sees as picking up the best of Part F, industry decision-  
 26 making, where that is possible, but with final decision-making  
 27 in hard cases being left with the Crown EGB, or ultimately  
 28 with the Minister, whose decision-making rights will not be  
 29 constrained by the type of narrow appeal process that is in  
 30 the Rulebook. The arrangements in the counterfactual, in our  
 31 submission, get closest to ensuring a dynamically level of  
 32 investment is achieved, which is consistent with the national  
 33 interest, while the proposal can be expected to fall short of  
 34 this level.

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

36 **MS CALLINAN:** I'd like now to just hand however to Alex to talk  
 37 about over-investment.

38 **DR SUNDAKOV:** Thank you very much. I'd like to just fairly  
 39 briefly deal with the flip side of under-investment, and  
 40 that's the potential for over-investment that the Commission  
 41 has identified in the Draft Determination under the  
 42 counterfactual as compared to the proposal. I will then go on  
 43 and deal with a couple of other issues that are set out in the  
 44 submissions and principally I will talk about the question of  
 45 contestability of transmission services and of other service  
 46 provision.

47 **MS REBSTOCK:** Just before you go on, can I ask one quick  
 48 question, and I apologise if you've already answered it. In  
 49 this last submission when you say that Part F will improve on  
 50 the status quo in that it will lead to coalition in support of

**Transpower (cont)**

1 investments in many cases. What sort of circumstances is that  
2 likely to be? I'm just having trouble understanding what are  
3 the circumstances. I mean there are some circumstances where  
4 it's agreed now. What is it that makes it more likely in the  
5 future?

6 **MR HEAPS:** One example would be in the Bay of Plenty where nodal  
7 price increases there are due to the transmission constraints.  
8 The constraints that we mentioned before have eventually  
9 increased the nodal price, so there are several participants  
10 there seeing a price signal and want to react to that. The  
11 problem with the status quo is that there may be hold-out or  
12 free-riding by one of those participants that knows that the  
13 others are suffering more than they are. So, they would hold  
14 out and that free-riding aspect makes it difficult for the  
15 others to invest. So, you get a brinkmanship(?) between the  
16 players.

17 **MS REBSTOCK:** So, it's only where you have hold-out by a  
18 significant minority.

19 **MR HEAPS:** That's one of the reasons that Part F was put in  
20 place.

21 **MS REBSTOCK:** You say that represents a lot of the cases?

22 **MR HEAPS:** I think that's -- that will work out if Part F was  
23 implemented. It's difficult to say how many of those would be  
24 sold because we don't know whether there are other underlying  
25 issues. But we think it's worth giving that a go.

26 **MS REBSTOCK:** You think it's significant, okay.

27 **MR HEAPS:** Yeah.

28 **CHAIR:** Just one further point. You said yesterday I think that  
29 it was relatively straightforward getting agreement on the  
30 issue and the need for it, and signing the cheque was when the  
31 problem arose. So Part F as drafted doesn't get to that end  
32 point in your view.

33 **MR HEAPS:** In some circumstances it may well do, because  
34 75 percent threshold will, or is designed, to overcome the  
35 hold-out by people wishing to free ride. So, in certain  
36 circumstances that may well get over that problem. But in  
37 substantial cases like the Auckland case that we've mentioned  
38 300 million, when we doubt that it will.

39 **CHAIR:** Thank you.

40 **MR THOMSON:** It's fair to say, Chairman, that the further north  
41 we go the more troubles we have. That's where the load growth  
42 is of course and that's where the major investment needs to be  
43 done. That's facts of life. Industrial relations in this  
44 country the further north you went, the always have more  
45 trouble.

46 **CHAIR:** It's been somewhat historical in this industry too,  
47 hasn't it from experience.

48 **MR CURTIN:** Speaking as an Aucklander, the opinion's mutual.

49 **CHAIR:** Thanks Mr Thomson.

50 **MS BATES:** Could I just ask a question about the appeal rights

*Transpower (cont)*

1 which you say are too narrow to deal with the circumstances  
 2 that you envisage arising. If those appeal rights were wider,  
 3 would it matter whether it was a Crown EGB, or an industry EGB  
 4 making the decision?

5 **MR CARVELL:** I think on that particular matter the answer is, no,  
 6 it wouldn't matter. If the appeal rights were wider there  
 7 would be access to an EGB which, under the rules, is intended  
 8 to have executive authority in this matter.

9 **MS BATES:** The EGB isn't intended?

10 **MR CARROLL:** It is, under both the proposal and the  
 11 counterfactual, under the rules if you can get an appeal to  
 12 the EGB, the EGB has the power to make the decisions, so  
 13 that's fine.

14 **MR THOMSON:** Provided everybody, and I mean everybody, is in the  
 15 agreement. One of the problems -- Part F and part C are  
 16 designed for everybody to be in. The trouble is if you get a  
 17 couple of major players outside, they free ride again.

18 **MS BATES:** Okay.

19 **CHAIR:** Dr Sundakov please.

20 **DR SUNDAKOV:** Thank you very much. Essentially I think I'll  
 21 continue with the discussion that's just started. In  
 22 considering the likelihood of over-investment under the  
 23 counterfactual, I think it's very important to have a very  
 24 clear view of what are the circumstances under which over-  
 25 investment can happen compared to the proposal. I think in  
 26 this regard it's useful to make a clear distinction between  
 27 two components of Part F and the Rulebook and two ways in  
 28 which transmission investment can proceed.

29 Firstly under Part F, investment can proceed to maintain  
 30 the agreed level of service and that level of investment  
 31 proceeds more or less automatically. Transpower will publish  
 32 its service delivery plan and if customers do not agree with  
 33 what's in there they can either engage Transpower in one way  
 34 or another, or they can explicitly alter the level of service  
 35 that they're willing to receive.

36 Depending on how the definition of what a level of  
 37 service is comes out, and obviously these discussions will  
 38 still need to be finalised, that part may actually capture  
 39 quite a large proportion of investment. For example, if the  
 40 level of service is defined in terms of a security level, so  
 41 in other words as load grows you have to keep investing more  
 42 and more in order to maintain a given level of security, then  
 43 it's quite possible that a very substantial part of  
 44 transmission investment will be captured by that part of the  
 45 Rulebook, and very little will go to the voting process.

46 Now, I think what I'd like to emphasise is that -- this  
 47 is building on the arguments that were presented yesterday and  
 48 today -- is that we would envisage that element of Part F to  
 49 be indistinguishable between the proposal and the  
 50 counterfactual. So, in other words all the investment that is



*Transpower (cont)*

1 put in to maintain the agreed level of service, exactly the  
2 same will happen under both.

3 **MS REBSTOCK:** Who develops that plan, the service delivery plan?

4 **MR ROBERTSON:** Transpower develops that service delivery plan.

5 **MS REBSTOCK:** What are your requirements? Does somebody approve  
6 it or do you consult or?

7 **MR ROBERTSON:** The intention of the service delivery plan is that  
8 it be published and be used as a vehicle for consultation in  
9 respect of resolving, in participants' minds, the best  
10 alternative for solving the issues raised in the document I  
11 mentioned yesterday, the statement of system adequacy.  
12 There's a hierarchy of documents, statement of system  
13 adequacy, a statement of investment opportunities and a  
14 service delivery plan, the service delivery plan is the so-  
15 called asset owner's response to the issues in respect of  
16 power system management.

17 **MS BATES:** Is there consumer preferences fed into that?

18 **MR HEAPS:** Another input are the service definitions which have  
19 been, for the current level of service they have been worked  
20 through a process which, if there isn't resolution between  
21 Transpower and the customers, it goes to arbitration. So, the  
22 current service is defined more clearly perhaps than it is  
23 now, or more meaningfully, and service levels for the current  
24 level of service is set against those definitions and that's  
25 one input into the service delivery plan. So, the answer is  
26 yes, the needs of customers are factored into the service  
27 delivery plan.

28 **DR SUNDAKOV:** One could argue, and I'm sure some will, that the  
29 service definition levels or the service delivery plan that  
30 comes out within agreed level of service may or may not, I  
31 mean I have no way of judging, have a degree of over-  
32 investment, or may in some ways be different from optimal.  
33 One can't judge this.

34 But I think the key point here is, it will be exactly  
35 the same under the proposal and the counterfactual. So if  
36 there is any bias on that either to over-investment or under-  
37 investment, it will be absolutely identical under both.

38 So, the difference, if there is any difference between  
39 the proposal and counterfactual, will be in the other area of  
40 investment and that is investment that's related to changes in  
41 the agreed level of service, primarily to increasing the level  
42 of service.

43 Here again I think it's important that there will be  
44 clearly a number of transactions which are bilateral between  
45 Transpower and one of its beneficiaries, which will proceed in  
46 exactly the same way under the proposal and under the  
47 counterfactual. There will also be a number of transactions  
48 which involve multilateral contracting and can proceed through  
49 a voting arrangement that again will proceed in the exactly  
50 identical way between the proposal and the counterfactual.

**Transpower (cont)**

1           So, the only difference is, in terms of those  
2 transactions that fail to go through a multilateral voting  
3 process, fail two years in the running through -- fail to go  
4 through to votes and come back to the EGB on appeal. The  
5 difference is that under the Crown EGB there will be more  
6 proposals come back on appeal than under the industry EGB as  
7 currently being proposed. So, the risk of over-investment, if  
8 any, has to be considered very much in the context of that  
9 difference in the number of proposals that come back on  
10 appeal.

11           Now, I think in order to decide how significant and  
12 whether there is any potential for over-investment, one then  
13 has to think through what that appeal process is likely to  
14 look like. Both the industry EGB and the Crown EGB is  
15 essentially going to be dealing with a proposal that has gone  
16 through quite an exhaustive working group process that has  
17 gone through a number of voting exercises and has come back,  
18 and in other words in order for that -- once it's come back on  
19 appeal, in order for that project to proceed, a fairly  
20 skeptical EGB has to be convinced that this is in national  
21 interests. I would suggest that both industry EGB and Crown  
22 EGB will be equally skeptical, given that they will be faced  
23 with proposals that have effectively been rejected.

24           So, in other words both bodies would need to be  
25 convinced that this proposal indeed has net public benefit,  
26 that the reason why the proposals have been rejected have to  
27 do with the inability to reconcile conflicting interests and  
28 to capture all the externalities rather than the fact the  
29 proposal should not proceed for good reasons.

30           I think the point is it's going to be extremely  
31 difficult in this environment to push through projects which  
32 are truly inappropriate, or projects that run against net  
33 public benefit.

34           So, I think that it seems to me that it's highly  
35 unlikely there will be any real difference between either the  
36 industry EGB or the Crown EGB in terms of that risk of over-  
37 investment; because both of these bodies are going to be  
38 dealing on appeal with the sort of proposals that have a lot  
39 of investment already been put into thinking them through,  
40 into identifying least cost options. Because clearly if  
41 you've come back on appeal you're going to be on very weak  
42 ground if someone can come in and say well actually that's not  
43 the least cost option.

44 **MS BATES:** But this is on the basis -- you said the difference is  
45 that more matters would come before the Crown EGB and that's  
46 predicated on the basis that a Crown EGB would have wider  
47 appeal rights.

48 **DR SUNDAKOV:** That's exactly right.

49 **MS BATES:** But apart from that, if the appeal rights were the  
50 same --

**Transpower (cont)**

1 **DR SUNDAKOV:** Then there'd be no difference at all.

2 **MS BATES:** -- then there'd be no difference in process in  
3 principle.

4 **DR SUNDAKOV:** Absolutely. If the appeal rights were identical  
5 then there would be no difference in terms of either likely  
6 risk of over-investment and I think as my colleagues have been  
7 saying, or in terms of risk of under-investment.

8 I think in relation to this I'd also like to address a  
9 couple of points that have been raised by LECG in terms of the  
10 incentives towards over-investment and also a suggestion that  
11 alternative service provision, and including alternative  
12 transmission investment, may be crowded out under the Crown  
13 EGB.

14 I think the key point that LECG made was kind of a  
15 general theoretical point that natural monopolies may have an  
16 incentive to over-invest, to widen their rating base in order  
17 to earn a higher rate of return. That's a kind of a general  
18 theoretical criticism of behaviour of these organisations  
19 under historical cost based accounting where to the extent  
20 that you're able to earn a higher rate of return, even if it's  
21 regulated, a rate of return that's higher than your weighted  
22 average cost of capital, it makes sense for you to keep  
23 building up the rating base in order to increase the overall  
24 profit of the organisation. I think that's an entirely  
25 correct statement of theory.

26 The point though is, that the ODV process is  
27 deliberately designed to deal precisely with that problem,  
28 that's exactly why it was brought in. So, in the context of  
29 the actual regulatory environment, given there is the ODV  
30 process, I think this general statement simply doesn't apply.  
31 This is particularly so given Transpower's Statement of  
32 Corporate Intent quite deliberately tells it to aim to earn  
33 its weighted cost of capital. So, it has no incentive to  
34 simply pile up, even if it could in the absence of the ODV, to  
35 simply pile up the investment base, because it could never  
36 earn more than the average weighted cost of capital.

37 If I can move on and deal with the question of crowding  
38 out. The suggestion that has been made is that under the  
39 Crown EGB there would be less likelihood of alternative, I  
40 think essentially merchant transmission investment coming in,  
41 or of alternative solutions being found. I think I've already  
42 dealt with the question of alternative solutions because the  
43 Rulebook processes, with the exception of appeal rights, would  
44 be the same under both the proposal and the counterfactual,  
45 are designed to reveal alternative solutions and make it  
46 fairly difficult to go ahead with a solution that's not the  
47 least cost solution for a particular problem.

48 But if we consider the question of alternative  
49 transmission providers, it seems again that the reality is  
50 that it's very hard to identify any differences between the

**Transpower (cont)**

1 proposed industry EGB and the Crown EGB. I think the  
 2 suggestion that the Crown is relatively less likely to  
 3 contract out services just simply doesn't stand up to  
 4 empirical observation the way the New Zealand Government  
 5 operates. The New Zealand Government contracts out a  
 6 tremendous number of services and there is a tremendous degree  
 7 of contestability of service provision across the board, not  
 8 just in the electricity sector, but in every sector in which  
 9 the Government is involved.

10 So, I think it's unlikely that there is some kind of  
 11 inherent bias in the way the Government deals with the ability  
 12 to obtain least cost services compared to the way the industry  
 13 EGB may deal with this. Again, the appeals processes, which  
 14 is the only difference, and the very fact that there is an  
 15 onus of proof on the project to go ahead, and the need to  
 16 satisfy the onus of proof will drive the submitters of that  
 17 project to show they have tried every alternative and have  
 18 identified every possible way of cutting costs, is likely to  
 19 mean that to the extent that services can be competitively  
 20 provided, they're going to be competitively provided under  
 21 both the Crown EGB and the industry EGB.

22 **MS BATES:** Can I just stop you because I want to make sure I'm  
 23 following the gist of what you're saying. Yesterday it was  
 24 put to us that there was an inherent conflict in having the  
 25 Minister as the decision-maker in situations where the Crown  
 26 owned a significant number of the key players. Now, do you  
 27 accept that there is at least a potential conflict there,  
 28 potential for conflict?

29 **DR SUNDAKOV:** I think in theory, yes there is. In practice we  
 30 know that the way the procurement processes work in  
 31 New Zealand governments, certainly nobody has ever been able  
 32 to identify any preference to Government owned providers. If  
 33 there is a bid and one of the bidders is Government owned and  
 34 other bidders are privately owned, I'm just simply not aware  
 35 of any suggestion that there's ever been any preference.

36 **MS BATES:** What you're saying is there may be a potential, but  
 37 experience would show that the potential has not become a  
 38 reality, so it's not a worry?

39 **DR SUNDAKOV:** I think that's right. Clearly if that potential to  
 40 influence the choice exists then the same argument -- and I  
 41 think it doesn't apply in either case -- but the same argument  
 42 could be transferred to the industry EGB to the extent that  
 43 one of the bidders is a member of the club and somebody else  
 44 from outside the club wants to bid in.

45 **MS BATES:** Yes, I accept there is that to some extent, but the  
 46 industry EGB is removed from that direct decision-making  
 47 control that the Minister has with the Crown EGB, because  
 48 after all it's the Minister that has the power, not the Crown  
 49 EGB. So that at least in theory the industry EGB doesn't have  
 50 the conflict problem.

*Transpower (cont)*

1 **DR SUNDAKOV:** I accept in theory there may be some difference.  
2 Sorry Mr Thomson wanted to come in.

3 **MR THOMSON:** Can I turn that around. If that's the case, you  
4 haven't got a market, you've got 75% of the generation  
5 retailing owned by one person, they show no bias to interfere  
6 in their decisions. If you apply that theory to one place  
7 you've got to apply it to the other. You've got a completed  
8 dominated generator in the industry, the Crown owns three out  
9 of four major generators. The practical application of what  
10 Alex is talking about is they do not interfere there, they  
11 leave them to their own. So, I mean they won't do it, it's  
12 dynamite, and they haven't separated the shareholdings between  
13 Ministers. All the shareholders are between the same two  
14 Ministers, not like in the old days.

15 **CHAIR:** That's fair enough. The point was made by -- that has  
16 been hinted at by other submitters, so that was the reason the  
17 question was asked to get your view on it.

18 **MR THOMSON:** I don't think they do, Chairman. My experience is  
19 that the generators are left -- are far more -- well they're  
20 more independent than the monopoly.

21 **DR SUNDAKOV:** I think also, I would just simply add to that  
22 point, that Government procurement processes are under much  
23 more scrutiny than private procurement process and as the head  
24 of an organisation that constantly bids for contracts with  
25 both private and public sector there's no doubt in my mind  
26 that the public sector goes through had much more careful  
27 processes to avoid any suggestion of unfairness or bias,  
28 simply because it has to and it's under considerably more  
29 scrutiny.

30 Can I also though deal with another issue to do with  
31 this suggestion that there may be crowding out of merchant  
32 investment. That has to do with the role of price regulation,  
33 the role the Commerce Commission itself is likely to play. I  
34 think that the key point here is that in order for merchant  
35 transmission investment to proceed, given the risks involved  
36 in merchant investment, the owners of such projects, or the  
37 promoters of such projects, would have to aim for a rate of  
38 return that's likely to be significantly higher than the  
39 likely regulated rate of return, or the regulated price that  
40 may be available to Transpower under the price control  
41 arrangements, which I know the Commission is going to be  
42 considering.

43 In other words, what's likely to happen is that for  
44 contestable transmission service to arise there would have to  
45 be quite an explicit exemption from you, from the Commission,  
46 for a particular type of service to enable that merchant  
47 investment to proceed. If that exemption doesn't happen, it's  
48 simply not going to proceed. Nobody's going to be incurring  
49 bidding costs which are very very high in these kinds of  
50 activities and the commercial risks, if they're not able to

**Transpower (cont)**

1 earn greater than the regulated prices, or regulated rates of  
2 return.

3 So, in other words, again there's likely to be a  
4 relatively public process of applicants coming to you,  
5 enumerating the arguments for exempting a part of transmission  
6 service from the regulatory framework, enumerating the  
7 benefits of that, and that will be on public record.

8 So, when the EGB, either the Crown EGB or the  
9 industry EGB, then comes to consider a particular project, and  
10 that's the kind of project for which that exemption has been  
11 sought, and that's been stated very publicly, that there are  
12 benefits for proceeding in a contestable manner with that  
13 particular investment; it seems to me completely implausible  
14 that either the industry EGB or the Crown EGB would not look  
15 at offering a tender for that kind of investment. I hope I'm  
16 making myself clear.

17 All I'm saying is that's just another -- the fact that  
18 this will have to go through an interaction with the Commerce  
19 Commission and all the arguments would need to be publicly,  
20 would itself guarantee that both the Crown EGB and the  
21 industry EGB would ensure the contestability, where it is  
22 possible, does go ahead.

23 **MS REBSTOCK:** Is it right to say it would necessarily come to the  
24 Commerce Commission?

25 **DR SUNDAKOV:** Well, in the absence of coming to the Commission,  
26 that kind of transmission investment is going to be covered by  
27 the legislation, by the current price regulations. So, the  
28 only way for me, as a merchant investor, to be able to recover  
29 my bidding costs and my risks is either not to proceed or to  
30 come to you to be able to price in a way that takes me outside  
31 the regulations.

32 **MS REBSTOCK:** I guess my question -- I want to think about this  
33 before I put it to you -- but it was more about -- the prior  
34 question may be what happens in the pricing methodology stage,  
35 it may actually foreclose those opportunities, so it never  
36 even gets to the point of coming to the Commerce Commission.  
37 That may happen because under Part F who gets a say in what  
38 happens at the pricing methodology stage, which may or may not  
39 come to the Commission?

40 **DR SUNDAKOV:** The pricing methodology has two elements. The  
41 first element, and that's the one that is likely to be pre-  
42 determined in some way, is to do with the allocation of sunk  
43 costs of the transmission network. That's not going to be  
44 relevant for new investment.

45 **MS REBSTOCK:** That's not what we were told yesterday.

46 **DR SUNDAKOV:** You think it will be relevant for new investment?

47 **MS REBSTOCK:** That certainly was, as I understood it, part of the  
48 submission of Todd Energy.

49 **DR SUNDAKOV:** It's hard to see were the logic of that would be.  
50 They're saying that at the margin the way that sunk costs are

**Transpower (cont)**

1 dealt with, and particularly if they're dealt with in a non-  
 2 distortionary manner, are going to change -- sorry I just  
 3 can't, there may be logic in it, but I can't quite see this.

4 **MS REBSTOCK:** Maybe you ought to look at their submission and  
 5 comment on it, because I suspect that you may want to comment  
 6 on it if you have a look at it.

7 **DR SUNDAKOV:** Okay. Perhaps it comes from a different economics  
 8 textbook to the one I've read.

9 **MS REBSTOCK:** I'm sure there's more than one way to look at  
 10 what's distortionary in terms of how you spread the cost of  
 11 the fixed cost of the --

12 **DR SUNDAKOV:** That's certainly true. But the way the  
 13 distortionary is defined and the way it's been interpreted;  
 14 for example, if you look at Transpower consultation document  
 15 on the development of price transmission methodology,  
 16 distortionary is quite explicitly defined as meaning "not  
 17 affecting future decisions".

18 **MS REBSTOCK:** Anyway, rather than trying to discuss it when you  
 19 haven't, I don't think you were here for their submission, but  
 20 if you have a look at it, we wouldn't mind having your  
 21 comments if you can look at it during the break?

22 **DR SUNDAKOV:** Perhaps we can do that after the tea break.

23 **MS BATES:** Do you have a copy of the submission and the  
 24 supplementary supplement?

25 **DR SUNDAKOV:** I've just got the transcript here.

26 **MS BATES:** There's more than the transcript. Perhaps they can be  
 27 made available to you.

28 **DR SUNDAKOV:** Thank you. Sorry, just lost my train of thought.  
 29 Oh, yes, coming back to the investment process. Just --  
 30 sorry, the question of pricing methodology, if we put the  
 31 question of the way that prices are allocated, prices are set  
 32 for sunk costs investments, the forward looking prices under  
 33 the Rulebook are left to negotiation between parties. So, in  
 34 that sense I wouldn't expect any difference between the  
 35 proposal and the counterfactual because that would be  
 36 negotiated.

37 If I can, in the same context, if I can deal then with  
 38 the issue of contestability of other service provision. Again  
 39 I think that what I'd like to address is this argument that  
 40 there would be a greater chance and therefore greater  
 41 efficiency, greater chance of contestability of the provision  
 42 of services such as system operator services, or market  
 43 manager services under the industry EGB compared to the Crown  
 44 EGB.

45 Again I think it's very important to, in order to deal  
 46 with this, to actually form quite a detailed view of how the  
 47 contestability is likely to arise. The system operator role  
 48 at the moment is combined with the transmission provider role  
 49 and resides in Transpower and in theory it's done in a number  
 50 of other jurisdictions. The system operator may be separated

*Transpower (cont)*

1 out.

2 I think that what's critical though is that the system  
3 operator and the transmission provider in our context are both  
4 owned by the Government and the likely separation of the two  
5 roles would require Government decision, under either the  
6 industry EGB or the Crown EGB. So, to the extent that the  
7 Government comes to that view, that separation would occur, or  
8 not occur, I think with equal chance under both governance  
9 arrangements.

10 **MS REBSTOCK:** I hadn't understood that there was a process under  
11 the proposal by which a decision separating the roles could be  
12 made by the industry EGB through the industry EGB process, is  
13 that not right? Would it require the Government to agree?

14 **MR CURTIN:** I have a vague memory of something like the  
15 Transpower being the initial system operator for a period of  
16 time after which there was some kind of formal contestability  
17 process, but it's been a while since I looked at it.

18 **MS REBSTOCK:** That itself was going to be put to a vote.

19 **MR THOMSON:** Under clause 9, responsibilities of the Governance  
20 Board. Government Policy Statement -- or clause 10 sorry.

21 "The Governance Board may also make recommendations from  
22 time-to-time to the Government as Transpower's owner on any  
23 services provided by Transpower that could be made contestable  
24 in the interests of efficiency."

25 So, in other words it has to be referred back.

26 **CHAIR:** That is because the Government's the owner rather than it  
27 intrinsically needing Government approval, isn't it?

28 **MR THOMSON:** I actually think it's because ultimately it's an  
29 essential service and they're very scared about security.

30 **DR SUNDAKOV:** I think it's a mixture of the two because you're  
31 correct that under the Rulebook this process --

32 **MS REBSTOCK:** Under the Rulebook I think is not consistent with  
33 what Mr Thomson just said.

34 **MR THOMSON:** No, but that's because the Rulebook is not  
35 consistent the Government Policy Statement.

36 **MS REBSTOCK:** I'm pursuing this because my understanding is the  
37 Rulebook is not consistent with -- and I'm not even sure the  
38 GPS says it must. It says it can. But what does the Rulebook  
39 say, if you wouldn't mind?

40 **DR SUNDAKOV:** The Rulebook says that, "following the expiry of  
41 the contract appointing Transpower as the initial system  
42 operator, every subsequent appointment of a system operator  
43 will be made in accordance with this rule 2", which is  
44 somewhere further back, does allow a degree of contestability.

45 But I think if I may just --

46 **MS REBSTOCK:** Can I just, before we go on, I just wonder  
47 Mr Thomson, legally can -- regardless of what the Rulebook  
48 says -- can the industry under the Rulebook take that role  
49 away from Transpower? I mean I understand the role could be  
50 made contestable, but legally, what is the basis for the rule



*Transpower (cont)*

1 as its written that suggests that the industry could make the  
2 decision to make it contestable?

3 **MR THOMSON:** Probably -- I'm not certain myself, I'm not a  
4 lawyer, but probably if Transpower joined they could take it  
5 away, but if they didn't join they probably can't.

6 **MS REBSTOCK:** You think that's the --

7 **MR THOMSON:** I'm not certain, but that's where I think I'd get  
8 to.

9 **MS REBSTOCK:** Well that sets up some interesting dynamics,  
10 incentives for you to join, doesn't it?

11 **MR THOMSON:** I'm not certain about the joining not joining, it's  
12 a board decision, that will have to be very carefully thought  
13 through.

14 **MS REBSTOCK:** I'm certainly interested in your legal advisors'  
15 view on the -- if that's what it is, that legally it could  
16 happen without your consent if you joined the Rulebook.

17 **MS CALLINAN:** Would we be able to get back to you after the break  
18 on this, we need to confer on it?

19 **MR THOMSON:** I think you'll find the applicant says that there  
20 will be a contract arranged before the -- it was always the  
21 intention to get a contract arranged for the system operator  
22 before the formal joining took place. It was envisaged that  
23 that was going to be four, five, six years. You couldn't  
24 separate the system operator at the present time, all right.  
25 Technology comes into it and technology's moving so that the  
26 function changes over time as IT comes in and you get more  
27 electronic on the grid. It becomes more contestable.

28 **MS REBSTOCK:** Yeah, I understand that there are technical issues  
29 around the separation of the roles, and I appreciate that  
30 being clarified. But I'm just wondering about the legal  
31 position, because since reading the Rulebook I've wondered  
32 about on what authority can the industry, in itself, through a  
33 voting mechanism or whatever, decide to separate the roles.

34 **MS BATES:** Transpower, by joining, would be agreeing to that set  
35 of rules dictating how it was going to go, is my not  
36 particularly well-considered view on it, but that would be my  
37 gut reaction to it.

38 **CHAIR:** Perhaps you could let us have a view, but depending upon  
39 the legal position if you were -- assuming joining the  
40 Rulebook you took the obligations and benefits out of that,  
41 all things being equal, a change could be made in a  
42 contestable service without the Government having a say at  
43 all.

44 **MR THOMSON:** That's right. But look can we have a talk over  
45 smoko?

46 **CHAIR:** Please, yes.

47 **DR SUNDAKOV:** Certainly my analysis was based on the  
48 understanding that the GPS would prevent a unilateral decision  
49 by the industry.

50 **MS REBSTOCK:** The GPS doesn't sound that way to me, because it

**Transpower (cont)**

1 says -- it's permissive, it doesn't require that the industry  
2 EGB come back to the Government. But --

3 **CHAIR:** Let's have a look at it and perhaps come back after the  
4 break, thank you.

5 **DR SUNDAKOV:** The other question of contestability that comes up  
6 is the market manager role that the role can't be get played  
7 by M-Co, that's likely to be made contestable. I would  
8 suggest again that the likelihood is there would be no  
9 difference between the two. If anything it may well be that  
10 there's less chance of that role being made contestable under  
11 the industry EGB, simply because M-Co, as the market manager,  
12 is so critical and the investment and process knowledge and  
13 detail that's involved in running an industry process is so  
14 critical, the cost involved in changing from an incumbent  
15 market manager to an alternative market manager would be  
16 significantly higher under an industry EGB than there would be  
17 under a Crown EGB, there wouldn't be the same intricate  
18 involvement.

19 **CHAIR:** Just a very quick question, if you were tendering for the  
20 market manager, currently the work that M-Co's doing in  
21 relation to the costs of setting up a contestable service,  
22 that would be part of the price of your bid, and simply the  
23 price that market participants weighed up as to whether they  
24 continue your contract or put a new one in?

25 **DR SUNDAKOV:** Sure. But I think the difference is that because  
26 the investment that has been undertaken by the market manager  
27 is so specific, specific to the processes and specific to  
28 the --

29 **CHAIR:** To the operation of the market.

30 **DR SUNDAKOV:** -- To the operations as they're currently carried  
31 out, it's highly unlikely that an external bidder would be  
32 able to be competitive. It's what in transaction cost  
33 economics is called a fundamental transformation, once you're  
34 your relationship is transformed. Once you've made that  
35 specific investment it becomes exceptionally hard for the  
36 outsider to come and replicate it. Whereas given that the  
37 market manager is not going to be so intricately involved in  
38 the processes that will be run by the Crown EGB it may be that  
39 investment wouldn't be so specific.

40 **MR CURTIN:** Could I just try one argument again, just repeating  
41 something that was put to us rather than our own views  
42 necessarily. But yesterday, whenever it was, Todd Energy  
43 talking about the operation of their market pool claimed one  
44 of the advantages was that they were much less bureaucratic  
45 and much less expensive to run their particular market,  
46 admittedly different in scale, and I just wondered if there  
47 was, taking your point about specialised assets involved and  
48 knowledge, I wonder if there wasn't just perhaps a commercial  
49 case that this might be more open than you're suggesting?

50 **DR SUNDAKOV:** Well, I mean if it is, NZEM processes are

*Transpower (cont)*

1 currently -- have nothing to do with the Government, its  
2 entirely industry run. So, if there is somebody who's more  
3 efficient and is cheaper and they haven't succeeded in winning  
4 the business, then, you have to ask why.

5 **MS REBSTOCK:** I think that Todd Energy position was that  
6 bilateral trading would disappear, so you'd get a -- besides  
7 the issue about contestability of the services that NZEM would  
8 provide, you also remove a whole competition to NZEM itself.

9 **MR THOMSON:** Sorry for butting in, Commissioner. I think Todd's  
10 pool free rides off the NZEM pool price. I think that's been  
11 the problem with all the subsidiary pools. They have actually  
12 taken the price that NZEM, and you're better to ask NZEM, but  
13 I'm pretty certain they take their prices as a base and they  
14 don't pay for it.

15 **MS REBSTOCK:** What do you mean by free-riding?

16 **MR THOMSON:** They use it as a reference price. You're better to  
17 ask Malcolm Alexander, or one of the applicants about that.  
18 But there are free-riding issues around the subsidiary pools.  
19 Bill might know better than me. It's not what -- I think  
20 you've only been -- haven't been told the full story.

21 **MS REBSTOCK:** We might invite you to tell us the other part of  
22 the story, but it does at least seem to be a significant issue  
23 if currently there is an element of competition with NZEM and  
24 that is to be lost as a result of the proposal.

25 **DR SUNDAKOV:** I certainly can't judge Todd's argument, but  
26 whether their argument applies or not, it applies equally to  
27 the proposal and the counterfactual.

28 **MS REBSTOCK:** It may or may not. Their point was a Crown EGB may  
29 not remove the bilateral trading possibility that through  
30 MARIA exists -- I think it exists through MARIA, the option to  
31 be outside of the system. That in itself provides discipline  
32 on NZEM, and their submission, if I understood it correctly,  
33 was that it's not clear that a Crown EGB would dispense with  
34 MARIA and the bilateral trading arrangements in the way that  
35 the proposal seems to.

36 **MR THOMSON:** I am quite certain that Todd's pool actually uses  
37 the pricing arrived at as part of the NZEM process and uses  
38 that as one of their benchmarks and free rides on that price  
39 and doesn't pay for it, I'm sorry.

40 **MS REBSTOCK:** I don't understand the point. I'm asking you the  
41 question because I don't understand the point of, in what  
42 sense is that free-riding if they use it as a benchmark? Can  
43 you just explain it to me please.

44 **MR HEAPS:** The major part of free-riding on the NZEM comes from  
45 unders and overs. So, if the top pool doesn't balance, so  
46 their demand doesn't match the generation within the pool, or  
47 the generation doesn't match the demand, either side; if they  
48 have to either make up or sell then they do that through the  
49 NZEM. So, in effect the NZEM provides a balancing function  
50 for them free of charge. In effect MARIA, if you had several

*Transpower (cont)*

1 of these pools, you would always need the one that makes up  
2 the differences.

3 **MS REBSTOCK:** But don't they pay for what they have balanced  
4 through NZEM?

5 **MR HEAPS:** No.

6 **MS REBSTOCK:** How do they avoid that?

7 **MR HEAPS:** I can't say how --

8 **MS REBSTOCK:** They have to join NZEM in order to balance, do they  
9 not?

10 **MR HEAPS:** No, they don't.

11 **MR THOMSON:** I'm certain by talking to one or two people in the  
12 audience I could get you a proper answer at afternoon tea.

13 **CHAIR:** I think we should ask NZEM to cover that off  
14 specifically.

15 **MR HEAPS:** It's probably a good idea.

16 **CHAIR:** We'll do that. Are NZEM here? Malcolm, you might take  
17 some notice of that. We'll ask you a question later. Thank  
18 you.

19 **MS CALLINAN:** Thank you. What we'd like to do now is move back  
20 towards the beginning of our submissions after we've dealt  
21 with the substantial topic of the potential for pro-  
22 competitive rules to be blocked, we had at page 23 of the  
23 submissions, beginning of section 3, another section headed up  
24 "anti-competitive rules in the Rulebook".

25 This is a really related issue to the one that we've  
26 already made. We picked up on the fact that the Commission in  
27 its Draft Determination did not consider it likely that voting  
28 power would confer an ability to push through anti-competitive  
29 rule changes, and the primary reason that we perceive from the  
30 determination why the Commission reached this view was, and  
31 I've put down in paragraph 3.5 of the submission, that there  
32 were important checks on the ability to exercise voting rights  
33 to introduce anti-competitive rules.

34 Now, we've already, in the course of the submissions so  
35 far, talked about quite a number of those checks and I don't  
36 wish to take your time going through those again. But there  
37 was one particular check that we would like to return to,  
38 because it does appear to be quite significant. That was the  
39 check imposed by the Auditor-General and the annual reviews  
40 that the Auditor-General would conduct.

41 So, I don't propose to take you through the points in  
42 3.5. What I would like to do is focus on just one point which  
43 is 3.5(d) on page 24; where we say, just by way of  
44 introduction, that the Auditor General's role is at a high  
45 level, this is how we perceive it will be, and on an annual  
46 basis, and that there will be resource constraints that may  
47 limit the effectiveness of the Auditor General's role.

48 What we've done, in view of the questions posed by the  
49 Commission on how effective this role will be, is put some  
50 thought into how the relevant parts of the legislation would

*Transpower (cont)*

1 be interpreted by the Auditor-General, what type of annual  
2 performance standards might in fact be agreed under the  
3 legislation, and on that I'll hand over to Peter Robertson  
4 who, wearing his auditor's hat, as put some thought into this.

5 **MR ROBERTSON:** Thank you, really it's rather a monologue. I have  
6 notes here which are sort of exploring how we think this might  
7 work. I guess just to be clear from the outset, our view is  
8 that performance reporting and auditing regimes contemplated  
9 will not be an effective means of counter-balance to the  
10 issues we've identified in respect of anti-competitive rule  
11 changes. I just want to talk through our thinking around that  
12 point.

13 Perhaps starting with a background view, which is that  
14 if the arrangement is implemented as proposed, whether  
15 specifically we agree with it or not, we'd have to acknowledge  
16 that a significant enough majority of key decision-makers who  
17 have approved it have philosophically accepted the proposition  
18 that the industry knows best, and that we are likely to obtain  
19 better outcomes, the outcomes sought under the policy  
20 statement through the processes described in the proposed  
21 arrangements, which I would seek to sort of summarise as  
22 providing for a robust process of healthy debate around rules  
23 and methodologies by which the industry operates. The EGB  
24 itself, in that proposal, is established to manage this  
25 process. It does things like setting the agenda, encouraging  
26 and perhaps even cajoling behind the scenes. But in very  
27 limited cases does it do anything more than that.

28 I think our view is that the legislation itself  
29 contemplates this sort of role, in that in the sections of the  
30 legislation which contemplate the setting of performance  
31 standards and reporting against those, there is a requirement  
32 that the performance measures, and I'm summarising, but  
33 essentially have to be measurable and auditable. We suggest  
34 that point to the choice of a path down which those  
35 performance standards will go. If there were two paths to  
36 choose, one being quantitative and the other being  
37 qualitative, we would argue that this is pointing at the  
38 quantitative path, because they have to be measurable and  
39 auditable and it just gets progressively more and more  
40 difficult to go down a qualitative track.

41 Perhaps as an aside, although it may well be integral to  
42 this whole process as well, there must be a tension, which I  
43 think we explored a day or so back, between the board and the  
44 Government. The board presumably will be anxious to be held  
45 accountable for those things over which it has control, and  
46 that to us points to the board strongly arguing for  
47 performance standards which point to process effectiveness.  
48 I'll pursue that in a moment.

49 But I think we can also acknowledge the Government has  
50 stated quite clearly that it's not interested in the

**Transpower (cont)**

1 particular path by which the industry seeks to deliver the  
2 outcomes, it just wants to see the outcomes delivered. So,  
3 for their part they may look to argue for more substantive or  
4 qualitative measures, because they're really interested in  
5 seeing those outcomes delivered. I'll try and pursue both  
6 lines.

7 But we really simply tried to think about how you might  
8 go about setting some performance standards that were  
9 quantitative, what would you actually do. In the area of rule  
10 changes you may seek to set some level of numbers of rule  
11 changes, pro-competitive rule changes that you'd like to see  
12 coming through. Conversely you might say we don't want to see  
13 any -- perhaps goes without saying -- you don't want to see  
14 any rule changes come through that would be described as anti-  
15 competitive. So, just pursuing that idea, you might then see  
16 numbers, the resolution of stuck issues, speed and frequency  
17 with which those things happen, the breadth of industry  
18 participation in working groups, measures along those sort of  
19 lines.

20 It's hard to see how a focus on those process measures  
21 are going to deliver what's required under the legislation.  
22 The legislation is quite prescriptive in terms of the content  
23 of the report and the performance standards, that the EGB is  
24 to adopt. Amongst other things suggesting that the  
25 performance standard have to cover all of the items in the GPS  
26 that touch on the wholesale market and transmission, the  
27 provision of transmission services.

28 Critically the legislation requires, in the end, an  
29 assessment of the performance standard against which the EGB  
30 is to be judged each year as having achieved satisfactory  
31 performance. I guess in some ways that struck us as  
32 inevitable, because in the end if someone's going to have to  
33 form an opinion you have to pull all the loose ends together  
34 and establish a means of saying, on balance do we think this  
35 is working or not working.

36 My experience of wrestling with, perhaps at an  
37 individual level, assessing the performance of a staff member  
38 where you've got an array of performance measures, presumably  
39 you've established some priority to those performance areas,  
40 and you would then assess performance against those  
41 performance areas, and you will get an array of differential  
42 performance.

43 So, you may have one area which you determined had a  
44 high priority and you have a satisfactory level of  
45 performance. You have another high priority area where you  
46 have excellent performance. In total you might end up, for  
47 example, with five high priority areas with a mix of  
48 performance, let's say three goods and a poor. You might have  
49 some medium performance areas where you have a couple of  
50 excellents and a good. In the end how do you aggregate the

**Transpower (cont)**

1 outcome of all of those items?

2 I'd suggest it's hard enough at the level of performance  
3 evaluation for an individual staff member with a clearly  
4 defined job description, it gets progressively more and more  
5 complex as you move along the continuum from quantitative  
6 measures to qualitative measures, and considering, for  
7 example, the area of pro-competitive rule changes, do we say  
8 the auditor arrives at this task and says well, "let's take  
9 stock of the issues on hand at the moment and let's form a  
10 view of which issues and how many we'd like to see resolved at  
11 the end of the first 12 month period."

12 They take a view that we have ten high priority rule  
13 changes, is it conceivable they would say to attain a tick  
14 from our report at the end of this first reporting period you  
15 have to have achieved all ten? They may take a view, "we'd  
16 like to see you achieve seven out of the ten." but what if  
17 the other three that aren't achieved, may even have been voted  
18 down never to reappear, are critical to the successful role  
19 out of the seven that were achieved? We see this sort of  
20 dilemma, one, being inevitable, and two, leading to a  
21 situation where it becomes extremely difficult to give a  
22 negative report on behalf of the Auditor-General.

23 **CHAIR:** Just a couple of questions, I haven't been an auditor,  
24 I've been audited over the years in many different situations.  
25 The Act is reasonably explicit at 172.Z.M subsection 2(a)  
26 where it refers to the informed assessment to be made of  
27 performance against the GPS objectives and outcomes etc, so it  
28 attempts at least to put a reasonably specific overall  
29 criterion there.

30 Secondly, and I guess you've been an auditor and maybe  
31 still are, one would have thought that there would be some  
32 attempt to make a judgment about the qualitative relativity of  
33 issues. You mentioned seven out of ten rule changes. I would  
34 have thought that the Auditor-General, or any auditor would be  
35 looking at what is material and what isn't. It's very easy,  
36 as you say, to tick a box when you're filling in a performance  
37 assessment and it was certainly a technique, I think, employed  
38 by a number of organisations I've been associated with.

39 In this case, though, and the Auditor-General generally  
40 getting into much wider audits these days than just financial  
41 performance, is making qualitative judgments; and looking at  
42 that guideline under that section of the Act, one would expect  
43 those qualitative judgments to be framed in that context.  
44 It's difficult, I accept that, but I wouldn't suggest it's  
45 impossible.

46 **MR ROBERTSON:** Well, I think a couple of responses. First of  
47 all, I'm no longer a practising auditor, and I guess the  
48 origins of -- there's a school of auditing which started out  
49 under the heading of "effectiveness auditing" and I think  
50 Canada is credited with a lot of the original thinking around

**Transpower (cont)**

1 that, and I can't honestly speak to the continuing regime they  
 2 operate with there. But it did start out in the context of  
 3 five-yearly audits of effectiveness for Crown-owned companies.

4 The basic model for that was similar to this, in that it  
 5 relied on management representations as to effectiveness, and  
 6 a process of auditing those representations. The auditing  
 7 process relied on -- effectively attempting to substantiate  
 8 the representations that were made. So, going back to  
 9 evidence and we saw -- I know in ten or twelve years ago I can  
 10 recall, for example, spotting some of this sort of approach  
 11 appearing when New Zealand Post first introduced fastpost.  
 12 They made representations at the back of their annual report  
 13 as to the percentage of mail delivered with the fastpost stamp  
 14 on it, that had actually got through in accordance with the  
 15 time and they had an audit report that was attached to that  
 16 that attested to the accuracy of the representation.

17 But I think the issues we deal with here, in and of  
 18 themselves, become so complex and fraught with controversy,  
 19 there was a discussion, I think, two days ago that surely if  
 20 things were happening that were considered by us, for example,  
 21 to be anti-competitive, we would be squealing. It's quite  
 22 clear that we would and that the auditor would hear that. But  
 23 they'll hear the noise, they'll certainly observe that there  
 24 is controversy. But the issue is how do they determine  
 25 whether that's just controversy as a result of us losing a  
 26 legitimate vote? I mean at the end of the day philosophically  
 27 that's what this proposal -- under the proposed arrangement  
 28 that's the philosophical underpinning for it, so we lost and  
 29 we're not happy.

30 To go beyond that sort of more simple process view  
 31 requires the auditor to get involved in the nub of the issue,  
 32 and the Commission itself has experienced some of the, I'm not  
 33 sure how -- I won't put myself in your shoes and attempt to  
 34 describe it, but you get strongly held opinions on complex  
 35 issues on either side of the question.

36 **MS BATES:** Can I just butt in here and say -- I might be taking  
 37 an overly simplistic approach to it of course -- but say  
 38 everybody has identified as a major problem the fact that  
 39 there are constraints in the grid. Problem of under-  
 40 investment, probably impacting on prices to consumers, so  
 41 there's a theme everybody agrees on. Now surely it would be  
 42 possible to set objectives and outcomes around that, and for  
 43 the Auditor-General to be able to discern whether the problem  
 44 was being alleviated, whether it was all going in the same  
 45 direction and they may have a time frame to reach a certain  
 46 goal, but surely that would be possible to do that?

47 **MR ROBERTSON:** It's possible to do that. I think the -- if I  
 48 tried to respond to that in the context of the Auckland  
 49 project we discussed a bit today and a bit yesterday. There,  
 50 our views on the Auckland situation are they currently have an



**Transpower (cont)**

1 N minus 1 level of security and we talked a day or so back  
 2 about the range of international standards you might find in  
 3 respect of the provision of quality or security guidelines for  
 4 metropolitan areas and you'll find enough support to suggest  
 5 that that's okay. You would find a body of opinion that says  
 6 for an Auckland sized load you should have N minus 2.

7 Our forecast of demand growth suggests that N minus 1  
 8 can be sustained for about the next ten years and that rather  
 9 than rush to upgrade the assets around Auckland to N minus 2  
 10 we should be cognisant of the fact that these security  
 11 guidelines are always measured in the context of peak demand  
 12 and so an argument that we have made has been, you have N  
 13 minus 1 100% of the time, 80% of the time in fact you have N  
 14 minus 2.

15 In the intervening period we believe it is more cost-  
 16 effective to focus on having very effective contingency plans  
 17 in the event that something did go wrong in that 20 percent of  
 18 the time than to rush in to invest something in excess of \$300  
 19 million to solve the problem now. There will be others who  
 20 have different views on that, and I guess I'd have a concern,  
 21 if you take what you described as perhaps a simplistic  
 22 approach and you said, let's make this quite clear-cut, you  
 23 will start to pre-determine the outcome of those sorts of  
 24 judgments.

25 **MS BATES:** Well, I would think that you would be able to discern  
 26 a trend as to whether problems were being solved or whether we  
 27 are stuck with stalemates and delays. I think that would be  
 28 apparent.

29 **MR ROBERTSON:** So you might discern a problem in respect of  
 30 investment. You might. It may take some time before you felt  
 31 confident that there was a trend there. But this reporting  
 32 has to cover all outcomes under the GPS and has to be  
 33 aggregated in the form of an overall performance standard  
 34 against which --

35 **MS BATES:** Yes, but there are some key issues, there are key  
 36 issues.

37 **MR ROBERTSON:** Nevertheless my point would be that you still  
 38 have, somewhere you might be doing really well and somewhere  
 39 you might be dragging your heels.

40 **MS BATES:** Yes, but you'd have to make an overall assessment  
 41 against the prioritised incentives and I have difficulty in  
 42 accepting the impossibility of doing that.

43 **MR THOMSON:** I set objectives at Transpower with my board. They  
 44 are very difficult to set if they are not completely  
 45 quantitative like Peter said. These are not quantitative  
 46 objectives, they are woolly. You finish up, if you really  
 47 want to measure them and get the results, actually doing a  
 48 counterfactual's job. I'm sorry that's my --

49 **MS REBSTOCK:** Can I just ask you a question. In the  
 50 counterfactual you've put it to us that you'll have working

**Transpower (cont)**

1 groups and things will come up in pretty much the same way as  
 2 under the proposal. Now, you could arguably say that by the  
 3 time something's come up through the system and been finally  
 4 put to the Minister for a decision under the counterfactual,  
 5 that the Minister will face the same problem of not knowing  
 6 when somebody comes and says "that proposal's anti-  
 7 competitive" or "that proposal's this or that", face the same  
 8 problem of not knowing if you're not just complaining because  
 9 you happen to have lost through the whole process that got you  
 10 there.

11 So, and I think there is a point about whether you're  
 12 dealing with one issue or you're dealing with an annual  
 13 report. But when I come to that bit I also say well we can't  
 14 look at this annual reporting process in isolation, as if it  
 15 is the only thing that's happening here to hold this industry  
 16 EGB accountable. We know first of all that the Minister owns  
 17 75% of the entire business, so clearly he has ongoing ability  
 18 to exert influence outside of the annual reporting period, and  
 19 that was stressed at great length by the applicant, that you  
 20 have ongoing constraint that the Minister can apply on the  
 21 industry EGB.

22 I really do wonder how different is it in the end? On  
 23 the one hand we're relying on the same process to bring these  
 24 issues forward. At the end of the day the Minister's going to  
 25 find it hard as well to differentiate between the various  
 26 views that are being brought to him when he or she has to make  
 27 a decision, and under the industry EGB this annual reporting  
 28 process is not the only point at which the Crown can exert its  
 29 influence.

30 **MS CALLINAN:** Can I make a couple of points in response to that.  
 31 Just going back to the discussion we were having immediately  
 32 before you asked that question. Commissioner Bates said  
 33 surely it's not impossible for this kind of qualitative  
 34 assessment to occur. We agree with that. But the level of  
 35 resource that needs to go into making that kind of qualitative  
 36 assessment is, in our view, enormous given the complexity of  
 37 the industry and it's at that point that we see very little  
 38 difference between an Auditor-General who is going to perform  
 39 a proper qualitative assessment of how the industry is  
 40 performing and a Crown EGB. The two become quite similar at  
 41 that stage.

42 We don't think that that's what the proposal is actually  
 43 anticipating. This is why we say that under the proposal we  
 44 perceive the legislation would impose more quantitative rather  
 45 than qualitative checks, because otherwise you do get into a  
 46 situation where almost the same level of resource has to be  
 47 devoted to the Auditor-General as would be put into a Crown  
 48 EGB. I know that's exaggeration, but you see the point of the  
 49 merging of the two.

50 Just in relation to the last question, where we see the

**Transpower (cont)**

1 primary decision-making going on in the counterfactual is at  
2 the Crown EGB level. That is where the Minister, through the  
3 appointed representatives on the Crown EGB, is immediately  
4 going to have some direct impact on the kind of decisions that  
5 are coming through from the working groups.

6 So, it won't be necessary under that model for the  
7 Minister to go to the same lengths as the Auditor-General  
8 would have to under the proposal, because the Minister's input  
9 will already be in there through appointment of the Crown EGB.

10 **CHAIR:** I don't want to get into too much of a detailed debate,  
11 but just to make two points. I think Mr Thomson talked about  
12 the woolly objectives or woolly criterion under the industry  
13 EGB model in relation to the Auditor-General's role. I would  
14 have thought the Act, in relation to subsection 2 of that  
15 section talking about performance assessed against the GPS  
16 objectives, makes those reasonably specific, given that I  
17 think you've put a fair put of store on the GPS.

18 Then secondly, and again it's a matter of opinion, I  
19 think the Auditor-General over recent years has certainly gone  
20 into effectiveness or qualitative audits quite extensively.  
21 Certainly in organisations I have been in or am associated  
22 with have been subjected to these and has enabled himself or  
23 herself to obtain advice and resource to do these adequately.  
24 So, again it's a matter of opinion. But I would have thought  
25 there's a fairly even chance that if this was enacted and  
26 given to the Auditor-General as a role, there would be  
27 resource and processes developed that covered off the  
28 information issue which is what we're talking about. But  
29 anyway, there's a difference of opinion on it. That's only a  
30 view. The Commission hasn't taken a final view at all.

31 **MS CALLINAN:** Could I just make one final comment. Even if one  
32 accepts that the Auditor-General process is going to be  
33 effective in an industry this is complicated, there is a time  
34 lag issue. If the Auditor-General, to use Peter's example,  
35 gives a number of ticks and crosses to this industry and say  
36 the first time around the issue of under-investment is not  
37 sufficient for an overall negative report so you've got a gap  
38 of a year, the next time around that has become a critical  
39 issue. So, you do get a negative report.

40 Well, if you're looking at the Auckland example that  
41 might be 2006 and we needed the resource consents in 2003. We  
42 think that there could be a time lag issue with that, even if  
43 it is effective, that could lead to inefficiencies.

44 **CHAIR:** One's got to see how it works out, that's a fair point.  
45 I just wonder whether indeed it will be an all or nothing type  
46 of report. One would expect if there were gaps in performance  
47 they would be identified, and not just submerged as not being  
48 material.

49 **MS REBSTOCK:** You made an interesting remark that the Minister  
50 would be able to influence the Crown EGB through the

**Transpower (cont)**

1 appointments to the Crown EGB itself and my understanding is  
 2 the Minister has a veto right over who's appointed to the  
 3 industry EGB, and in that sense equally has the ability to  
 4 have some influence in the first place over who is appointed  
 5 to the industry EGB, and furthermore we've been told that the  
 6 industry EGB has a role in setting priorities for the working  
 7 groups in terms of what issues are to be considered. So, it  
 8 just seems to me that there is a lot more similarity here than  
 9 first meets the eye. Maybe more direct in the Crown EGB case,  
 10 but nevertheless it's nearly mirrored in the industry  
 11 approach.

12 **MS CALLINAN:** I think you can imagine what our response is to  
 13 that, it's simply that whilst that may be their case in terms  
 14 of the appointment, because the industry EGB is, in our  
 15 submission, a process manager, I accept that it will  
 16 prioritise. But because any substantial rule change goes out  
 17 to the vote, and at that point there becomes a  
 18 disconnectedness from the accountability that those industry  
 19 EGB board members might have to the Government and the  
 20 decision-making goes out to the industry itself.

21 **CHAIR:** Okay, I think we might just take a break for ten minutes  
 22 and resume at quarter to 3. Thank you.

23

24

**Adjournment from 2.35 pm to 2.52 pm**

25

26 **CHAIR:** I think we might recommence please. Just again before we  
 27 get into the substance to look at the ever-evolving timetable.  
 28 I think the objective is to finish at 4.00 this evening and  
 29 then Transpower, if they're not finished, reconvene at 9.00 to  
 30 10.30 this in the morning. I think NZEM can give us half an  
 31 hour after that Malcolm is that right?

32 **MR ALEXANDER:** That's correct, yes.

33 **CHAIR:** Then if Transpower's finished by 10.30 the applicant I  
 34 think is amenable to replying from 11 o'clock. I think if  
 35 Transpower goes beyond 10.30, has to start again at NZEM, then  
 36 we'll have to schedule a right of reply for next week. So, I  
 37 just put those as objectives we should try and move towards.  
 38 I mean I think if the right of reply was available tomorrow,  
 39 having said that, if Transpower doesn't finish by 10.30 the  
 40 applicant is quite rightly requested more time to prepare a  
 41 reply which will be next week to be scheduled.

42 **MR KOS:** From our perspective what we'd very much like to see is  
 43 this matter finishing tomorrow. Our reply is substantially  
 44 ready. The only question really is whether we (inaudible)  
 45 tomorrow morning. The only question will arise if Transpower  
 46 does not finish by 10.30. So, I'd like to urge the Commission  
 47 to encourage them to look at that as a deadline so we can  
 48 actually bring this thing to a conclusion.

49 **CHAIR:** We'll certainly take that very much on board. Thanks  
 50 Mr Kos. Ms Callinan.

**Transpower (cont)**

1 **MS CALLINAN:** Perhaps if I could just start by returning to one  
 2 of the questions that was left with us about the rule relating  
 3 to the potential split of the system operator from Transpower  
 4 as transmission owner. In the brief time we've had to look at  
 5 this we do agree with Commissioner Bates' top of the head  
 6 reaction to this, which is that if Transpower were to join the  
 7 Rulebook then it would be agreeing to that happening in the  
 8 future under the Rulebook. The point we would like to make is  
 9 we also see that being the position in the counterfactual.  
 10 So, to the extent that may affect contestability we see it's a  
 11 neutral thing.

12 **CHAIR:** Thank you. Let's move on please.

13 **MS CALLINAN:** We'd just like to make one final point in relation  
 14 to this discussion we were having on how the industry EGB  
 15 would be accountable, and Commissioner Rebstock did make the  
 16 point that there was some oversight of a large proportion of  
 17 the industry due to the fact that they were Crown-owned and  
 18 that is the case to the extent they are State Owned  
 19 Enterprises they have certain objectives under the SOE Act but  
 20 Allan Carvell's just going to comment on the level of  
 21 involvement by the Government through the SCI.

22 **MR CARVELL:** Yes, I think we've covered some of this territory in  
 23 earlier comments in different contexts, but clearly the  
 24 point's been made previously that SOEs are required to follow  
 25 commercial objectives. We talked about the extent to which  
 26 Transpower's commercial objectives sit alongside other  
 27 objectives. But it does come down to the fact that the  
 28 Ministerial intervention and influence over what an SOE does  
 29 is governed by the SOE Act and is reflected in the Statement  
 30 of Corporate Intent. That will therefore not run to  
 31 operational issues, such as their involvement with industry  
 32 working groups and those sorts of things, at least in our  
 33 expectation.

34 **CHAIR:** Thank you. All right let's move on please.

35 **MS CALLINAN:** We'd like to just briefly cover an example that we  
 36 put in the submission in relation to potentially, well what we  
 37 say is very potentially an anti-competitive rule. Because the  
 38 point we were making in this section of the submission is that  
 39 those rules could be promulgated under the Rulebook.

40 The example that we give at page 24, paragraph 3.6, is  
 41 in relation to transitional dispensation s. I can just  
 42 briefly summarise what transitional dispensation s are. It's  
 43 in 3.6(b). They have two principal features. The first is  
 44 that they exempt an incumbent asset owner from certain  
 45 security standards on an ongoing basis, and then secondly they  
 46 provide the quantifiable costs of arising from that  
 47 dispensation will be allocated not to the particular person  
 48 who sought the dispensation but across all asset owners.

49 Transpower has always supported the concept of an  
 50 exemption, a dispensation, but there has been some debate in

**Transpower (cont)**

1 the industry about how those costs should be allocated. The  
 2 point we're making with this example, however, is this. Under  
 3 the Rulebook, new entrants would be treated differently from  
 4 incumbents. Incumbents get the benefit of the costs of the  
 5 dispensation being spread across all asset users, and under  
 6 the Rulebook a new entrant must bear the direct costs  
 7 themselves. So, this is, on its face, a discriminatory rule  
 8 which could have an effect on new entry.

9 What we're saying is that this would be different under  
 10 a Crown EGB, this is a case in point. Under a Crown EGB we  
 11 would expect there to be no difference in the way costs were  
 12 allocated between a new entrant and an incumbent. Whether  
 13 that meant the costs would be allocated across all users,  
 14 depending on whether you were an incumbent or a new entrant,  
 15 or the other way around, it doesn't much matter. The point  
 16 that we're saying is that under a Crown EGB this  
 17 discriminatory aspect of the rule we would not expect to  
 18 exist.

19 **CHAIR:** Thank you.

20 **MS REBSTOCK:** In effect now, new entrants face that sort of  
 21 difference in the treatment don't they? I mean they have to  
 22 comply with whatever security --

23 **MR THOMSON:** Up till now, up till last year, exemptions were  
 24 given after a lot of careful study and careful work.

25 **MS REBSTOCK:** And what happened since -- why was it just up till  
 26 last year?

27 **MR THOMSON:** Because up till last year Transpower had the  
 28 authority to consider the security of the power system and see  
 29 whether you could get them on.

30 **MR HEAPS:** The issue here is how the costs are allocated. So,  
 31 currently if a generator, an existing one or a new entrant,  
 32 comes to Transpower for a dispensation, then the cost of that  
 33 dispensation are allocated to them, to the individual. What  
 34 we're arguing here is that there's an incentive for existing  
 35 generators to join the Rulebook. They have been offered a  
 36 dispensation where the costs get distributed on a wider basis.  
 37 The new entrants that come along later are not offered that  
 38 incentive.

39 **MS REBSTOCK:** I'm just trying to understand because I thought you  
 40 said you supported having the dispensation s.

41 **MR HEAPS:** Yes, we support the dispensation s because otherwise  
 42 there would be a higher cost of compliance and so where a  
 43 generator can't meet that standard, we support that it should  
 44 be an ability to gain a dispensation. What we don't support  
 45 is that there is an incentive for existing entrants to get an  
 46 advantage over new entrants -- existing players to gain an  
 47 incentive over new entrants. So, it's the cost allocation  
 48 that we don't support --

49 **MS REBSTOCK:** I understand that. I'm just trying to understand  
 50 why then did you remove the dispensation s that you could have

*Transpower (cont)*

1 provided, that you provided a year ago, why is that no longer  
2 applied?

3 **MR HEAPS:** We do still consider dispensation s for generators.  
4 So, we haven't --

5 **MS REBSTOCK:** You do?

6 **MR HEAPS:** Yeah.

7 **CHAIR:** Thank you.

8 **MS CALLINAN:** What we'd like to do now is move on to an issue  
9 that was raised a day or so ago, on market power and Alex  
10 Sundakov, there is a paper that's being handed out now that  
11 NZIER's prepared on this issue and Alex is going to speak to  
12 that.

13 **DR SUNDAKOV:** Before I do , that can I also try to deal with a  
14 question with respect to Todds and a comment they made on the  
15 allocation of sunk costs. We've conferred and tried to go  
16 through the transcript and the Todds paper and to be quite  
17 honest not entirely sure what to make of it. But it seems to  
18 me that there are a number of issues that Todds raise which  
19 don't seem to bear any relation to the question of how the  
20 allocation of sunk costs may affect future investment.

21 There are a number of cases they complain about changes  
22 to the ODV handbook, and ODV methodology, that's got nothing  
23 to do with the proposal or the counterfactual. They  
24 complained about a change in Transpower's pricing methodology  
25 which relates to the allocation of sunk costs and they said as  
26 a result of it they have refused to sign the contract for the  
27 recovery of these costs. That's a matter between Todds and  
28 Transpower. But it doesn't relate to future investments. I  
29 don't think Todds in any way raise the issue of future  
30 investment. They're just simply saying they refuse to sign  
31 the contract for the recovery of sunk costs. Good on them.  
32 If they can get away with not paying something.

33 **MS REBSTOCK:** My question wasn't in reference to those comments.

34 **DR SUNDAKOV:** The only other comments we could find related to  
35 the loss in constraint rentals. But again that's not sunk  
36 costs.

37 **MS REBSTOCK:** That's fine.

38 **DR SUNDAKOV:** Sorry, we just couldn't locate anything there.

39 Coming back to the market power issue. What we try to  
40 do in this paper is put together the evidence that I tried to  
41 recite from memory, but it was too fuzzy. Essentially, I'll  
42 be very brief and I think it maybe just the background  
43 material that you may find of use and interest. This is by no  
44 means an attempt to establish that the markets are failing in  
45 any sense. When we talk about market power it's not in terms  
46 of assessing that there is an intervention that may correct it  
47 or something where anything can be done.

48 The question that we addressed is whether the generation  
49 and the retail markets can be characterised as essentially  
50 being oligopolistic markets, markets characterised by small

**Transpower (cont)**

1 numbers games by persistent margins between prices and  
 2 marginal costs by possibility of strategic interaction between  
 3 the players which can assist in maintaining those margins  
 4 above marginal costs and by possible barriers to entry and  
 5 possibility that these barriers can be enhanced.

6 I think that's really all this suggests. What this  
 7 shows for example, with respect to nodal prices, is that the  
 8 spot prices for lengthy periods of times are maintained above  
 9 short run marginal costs of generation. Now, we would argue  
 10 that that's obviously necessary, but it's also evidence of the  
 11 fact that there's a degree of market power. As an example  
 12 here we provide evidence from August 1999 and that's simply  
 13 because that was before the last winter's electricity crisis.  
 14 That was a period when there was no concern about water  
 15 supply, no question of water conservation.

16 In terms of retail we have tried to clean out the  
 17 customer switching numbers for involuntary transfers of  
 18 customers. After that clean out we think there is a definite  
 19 trend in terms of reduction in the number of customer  
 20 switching and the overall rate of switching is relatively low  
 21 compared, say, to markets like the UK where its settled at a,  
 22 now, somewhat higher rate than the level of switching in  
 23 New Zealand.

24 **CHAIR:** I don't want to make too much of this, but if the  
 25 retailers had been better prepared to handle customer  
 26 switching, do you think the percentage might have stayed up?

27 **DR SUNDAKOV:** Well, to some extent the preparedness and the  
 28 willingness seems to relate to the degree of vertical  
 29 integration that exists and the availability of hedges. We  
 30 notice, for example, that Todds, their retail operations are  
 31 not accepting customers and that's something you wouldn't find  
 32 in a fully competitive market.

33 On the retail offerings, we use the Consumer Institute  
 34 website which lists various plans and various competitors  
 35 offerings in different regions to just construct a picture of  
 36 what is available to customers. Not surprisingly there's a  
 37 reasonable degree of competition in the major urban centres,  
 38 but you will find that we're essentially getting a degree of  
 39 regionalisation where there are two generator/retailers with  
 40 national generation capacity, capacity both South and North  
 41 Islands and that's Contact and Trust Power and they're present  
 42 in both South Island and North Island retail markets.

43 There are two generator retailers with only North Island  
 44 generation capacity, that's Might River Power and Genesis.  
 45 They're only present in the retail market in the North Island.  
 46 There's Meridian, which is a South Island based generator, but  
 47 is present nationwide, largely because we think of just the  
 48 sheer size of Meridian and the requirement to maintain  
 49 customer bases around the country.

50 What you see as a result of that absence of the two



**Transpower (cont)**

1 North Island generators from the South Island retail market,  
 2 even in the major urban centres in the South Island there are  
 3 only three retailers available, and going through outside of  
 4 the major urban centres in sort of reasonable sized country  
 5 towns, places like Gisborne, Taupo, Nelson, there are a number  
 6 of places in New Zealand where there are only two retailers  
 7 available.

8 Now again, that's not saying that there is a necessarily  
 9 intervention that would correct it, but it's simply saying  
 10 that this is very much a market that is likely to be  
 11 characterised by oligopolistic competition and therefore a  
 12 market that's likely to produce both incentive and opportunity  
 13 for the market participants, in interacting together through  
 14 the Rulebook process, to maintain or increase the margin in  
 15 their prices over marginal costs.

16 **CHAIR:** Just a procedural issue, I see you've got on the draft  
 17 "confidential".

18 **DR SUNDAKOV:** Sorry, it hasn't been cleaned, no, it's not meant  
 19 to be confidential.

20 **CHAIR:** No, because we'd like to circulate it, that's fine, thank  
 21 you.

22 **DR SUNDAKOV:** No, sorry that's just a short timeframe.

23 **CHAIR:** Thanks.

24 **DR SUNDAKOV:** No, this is a draft.

25 **CHAIR:** It's just that you know we like to make as much things --

26 **DR SUNDAKOV:** No, it's not confidential, this is all public  
 27 information.

28 **CHAIR:** Okay, thank you.

29 **MS REBSTOCK:** Thanks for coming back on that. We'll have a good  
 30 read on it. We appreciate it.

31 **CHAIR:** Thank you, Mr Callinan please.

32 **MS CALLINAN:** If we could then move on to page 36 of the  
 33 submissions, section 9 where we deal with the issue of  
 34 comprehensive coverage. Clearly as was expressed in  
 35 Mr Thomson's opening address, the mandatory nature of, or it's  
 36 Transpower's strong preference that the whole arrangement be  
 37 mandatory; but that issue to one side, the point of raising  
 38 comprehensive coverage in this context is that Transpower sees  
 39 that there will be costs associated with the lack of  
 40 comprehensive coverage under the Rulebook.

41 I just want to briefly touch on what those costs might  
 42 be and how they might arise. First of all we know that there  
 43 is a prospect that some participants won't join the Rulebook,  
 44 but perhaps it would be more useful, and Comalco has expressed  
 45 that view for instance, perhaps it would be more useful to  
 46 consider a scenario where the current industry participants  
 47 did join the Rulebook. In saying that I realise Transpower  
 48 has some strong objections to it. But if we consider that as  
 49 a hypothetical and then consider a situation where a new  
 50 entrant came along and did not wish to join the Rulebook, then

**Transpower (cont)**

1 what we're pointing to is some costs that may be associated  
2 with that type of scenario.

3 The first type of costs are that non-members may not  
4 comply with the mandatory elements of being connected to the  
5 grid and whilst we don't wish to delve into the details of the  
6 Kiwi co-generation joint venture at Hawera, we have, in the  
7 earlier submissions, set out some details about how this is a  
8 situation where Kiwi Cogen did not have a contract with  
9 Transpower. Transpower had problems with voltage control as a  
10 result, and the central issue was how would Transpower, in the  
11 absence of a contract, be able to impose obligations on a  
12 party that was connected to the grid, if they were, under the  
13 proposal, not a member of the Rulebook. That poses some real  
14 risks which we say would result in some costs in that type of  
15 situation.

16 The other cost would arise, in our submission, from the  
17 need to use quantum meruit to determine how prices for non-  
18 members were determined. We have a few points in relation to  
19 quantum meruit. Probably the most fundamental was quantum  
20 meruit is, of course, a legal principle of long-standing and  
21 it's not one that the Courts are unfamiliar with. It is one  
22 that deals with prices for services delivered. It is not the  
23 kind of principle that deals with non-price terms.

24 So, if for example we go back to the hypothetical  
25 example of a new entrant who wishes to participate in the  
26 market but not join the Rulebook, quantum meruit doesn't  
27 provide a solution in terms of forcing that new entrant to  
28 meet whatever obligations it needs to meet to maintain  
29 security of the grid. That is not an issue about a service  
30 received and a price for it. So, quantum meruit doesn't solve  
31 that type of problem.

32 The second point with quantum meruit is the applicant  
33 has suggested that many of the problems with determining a  
34 reasonable price would be solved by the Rulebook and the  
35 pricing methodology possibly having been sanctioned through  
36 Part F, or even through the Commission, if that is necessary.  
37 We consider that there would still be some room for debate  
38 about that, that there is a lot of scope for debate on what  
39 would be a reasonable price for something like, for instance,  
40 transmission services and that that wouldn't necessarily  
41 settle the issue.

42 **MS BATES:** Wouldn't one good case go a fair way to doing it?

43 **MS CALLINAN:** It might go some way towards doing it, but let me  
44 come on to the next point that we were going to raise.  
45 Because in the case that Transpower's had in the not too  
46 distant past with Trans Alta in relation to its generation in  
47 the top of the South Island, there was a dispute over whether  
48 Trans Alta ought to pay the HVDC charge.

49 Even if one assumes that the HVDC charge was sanctioned  
50 through Part F and it was allocated to South Island

**Transpower (cont)**

1 generators, in that case Trans Alta argued that it did not  
 2 receive the benefit of the HVDC link. That's a question of  
 3 service definition. What service is that customer receiving?  
 4 That issue wouldn't necessarily be resolved through the  
 5 Rulebook, or there would be potential for the Court to form a  
 6 different view on the service that that customer is receiving  
 7 from the service definitions in the Rulebook.

8 The point we're raising is that there may well be --  
 9 even one case like this may be very expensive cost and we see  
 10 that there's potential.

11 **MR CURTIN:** Just before we leave the comprehensiveness, I  
 12 understand the point you're make about the mandatory nature in  
 13 terms of complying with mandatory quality elements, and I  
 14 think Mr Thomson mentioned earlier that if there wasn't a  
 15 comprehensive agreement it could unravel some of the solutions  
 16 that have been proposed for free-riding, it would just allow  
 17 free-riding in another way.

18 I hear your point, but I wonder if all that justifies  
 19 what is a noteworthy feature of the proposal, and that is the  
 20 ban on bilateral physical trading, or other trading pools, or  
 21 trading arrangements. I can see, if you're looking at this  
 22 proposal from a competition point of view, a feature that  
 23 specifically bars alternative forms of trading rather stands  
 24 out for attention. I was wondering what was your comment on  
 25 the proposal's effective outgoing of bilateral trading outside  
 26 the market.

27 **MR HEAPS:** I think first of all you have to consider the economic  
 28 dispatch principle and that is that all generators  
 29 individually offer a price to the dispatcher and from there an  
 30 efficient spot price is determined. But the merit order of  
 31 power stations is then set and from that economic dispatch on  
 32 a national basis is enabled.

33 Around that spot price, any form of bilateral  
 34 arrangement can be formed. In fact I think the so-called  
 35 "Todd pool" isn't an effective pool, it's a bilateral  
 36 arrangement of generators. There is only really one pool.  
 37 That is to give economic dispatch through the system operator,  
 38 Transpower. So, I think that's very important, that  
 39 New Zealand has economically efficient dispatch through one  
 40 pool arrangement which is run by the system operator under  
 41 contract.

42 **MR THOMSON:** The alternative is in a normal position, if they  
 43 didn't pay they would not receive the service, right. We've  
 44 had a large number of legal opinions on whether we can  
 45 disconnect people and we've obviously never done it. We have  
 46 threatened to do it once. Legislation resulted, okay.

47 If you read the cases, which I'm certain some of the  
 48 Commissioners have done, on the Meridian case and the Trans  
 49 Alta case, it was quite clear that the judges told the  
 50 Government to regulate, right. There was no doubt about that.

**Transpower (cont)**

1 It was in the text, "this should be regulated". I think on  
 2 quantum meruit you'll get the same answer. The Courts are  
 3 very reluctant to set commercial terms in multilateral  
 4 agreements. I mean that's my experience, Anne's been our  
 5 lawyer on it. That's where we got to. I mean I've been  
 6 overseeing I suppose Court cases now for a few years, and good  
 7 lawyers.

8 **MS BATES:** Really?

9 **MR THOMSON:** They might have lost one or two, but they won one or  
 10 two.

11 **MR HEAPS:** Just coming back to my point. So, we have in  
 12 New Zealand economic efficient dispatch, so we get the merit  
 13 order in power stations. Bilateral contracts and bilateral  
 14 arrangements, such as the one that Todds have, can form around  
 15 that. I don't see either the proposed arrangements or the  
 16 counterfactual changing that.

17 But the core of our argument is that for security where  
 18 such things as frequency control, voltage are truly common,  
 19 and will require mandatory involvement in those standards when  
 20 they're set. So, if anyone stands outside, I think the Kiwi  
 21 Cogen example is a good one where that's a relatively small  
 22 power station on the whole system, it can substantially affect  
 23 the security of supply and the quality of supply certainly in  
 24 a region if it doesn't comply with standard mandatory  
 25 arrangements.

26 **CHAIR:** All right, please.

27 **MS CALLINAN:** Well that brings me to the end of section 9 and  
 28 then moving on to section 10 where we deal with the GPS at  
 29 page 38 of the submission. The reason why we address this, I  
 30 mean there has been a lot of debate in the industry about  
 31 whether the guiding principles faithfully reflect the GPS, but  
 32 the reason for raising the distinction between the two in this  
 33 context is that the Commission has found that there's some  
 34 potential for the proposed arrangements to lessen competition  
 35 or otherwise harm consumer welfare compared to the  
 36 counterfactual to the extent that the two principles vary.

37 Transpower agrees with that view that was reached by the  
 38 Commission and we just want to highlight some of the  
 39 differences between the GPS and the guiding principles, which  
 40 we do at 10.6 of the submission. Some of this, I believe, has  
 41 already been covered by Peter Robertson right at the beginning  
 42 of our submission, so I will go through it relatively briefly.

43 Under the Act, the principle objective of the Crown EGB  
 44 is to ensure that electricity is generated, conveyed and  
 45 supplied to all classes of consumers in an efficient, fair and  
 46 reliable, environmentally sustainable manner. This objective  
 47 repeats the wording of the government's overall objective in  
 48 the GPS. This part of the principle objective is not  
 49 contained in the industry Rulebook.

50 The applicant has directed the Commission to the

**Transpower (cont)**

1 foreword of the Rulebook. However, we would make two points  
2 in relation to the foreword. That excludes the first sentence  
3 of the GPS. You will see I have set out the sentence there in  
4 paragraph (c) subparagraph (i), and so it excludes the wording  
5 in relation to a fair, reasonable and environmentally  
6 sustainable manner of delivering electricity to all classes of  
7 consumer.

8 The second point, and this is significant in  
9 Transpower's submission, that the foreword is not a binding  
10 part of the Rulebook. The applicant declined Transpower's  
11 request to include the principal objective in the binding part  
12 of the Rulebook. Therefore, in our submission, the principal  
13 objective as set out in the GPS is unlikely to be either a  
14 significant constraint or a driver on the industry EGB.

15 Another point that we raise in paragraph D, which we've  
16 touched upon already in relation to under-investment, is that  
17 the GPS clearly envisages what we've called an "investor of  
18 last resort", or to pick up on the language used this morning  
19 a "final decision-maker in relation to investment". But the  
20 guiding principles, by contrast, emphasise the importance of  
21 collective decision-making.

22 The rationale for the divergence between the guiding  
23 principles and the GPS is that the guiding principles are  
24 better expressed, likely to be more enduring and have higher  
25 discriminatory power, clearer standards than the GPS. We say  
26 that that rationale doesn't stand up because the differences  
27 are not just terminological. In particular the guiding  
28 principles do not include references to achieving certain  
29 environmental objectives, and we've listed a few, hydro spill,  
30 climate change, greenhouse emissions and also other specific  
31 outcomes, like rules in relation to bids and offers.

32 The second main point that Transpower wants to make  
33 about the GPS is, in relation to the applicant's attitude  
34 towards the Government Policy Statement, the applicant stated  
35 in its presentation "we have taken the Government Policy  
36 Statement very seriously, we have no problem with it, no  
37 desire to skirt around it, and apply only the bits we can get  
38 away with." in Transpower's submission, this is not  
39 consistent with the previous approach to the GPS.

40 Page 40, we do set out a few instances where we say that  
41 approach has not been taken, and I'll just refer to the first  
42 one where Murray and Hansen in their initial submission  
43 considered the GPS to be quite unstable. Transpower has  
44 expressed some concern about the lack of alignment between the  
45 GPS and the RPGs and that concern has really not resulted in  
46 the change that Transpower wanted to the guiding principles.

47 Transpower considers that this evidence indicates that  
48 the project team is in fact uncomfortable with parts of the  
49 GPS and has tried to limit its impact on the Rulebook. The  
50 significance of this is that the evidence doesn't bode well

**Transpower (cont)**

1 for the effectiveness of the GPS as a constraint on the  
 2 industry. Even if the very same words applied under both the  
 3 counterfactual and the proposal, which clearly they don't,  
 4 their effectiveness as a constraint is partly determined by  
 5 the decision-maker's attitude towards them. I think that's  
 6 where we get to the fundamental difference between the  
 7 industry EGB and the Crown EGB, where the former is ultimately  
 8 driven by the self-interest of the industry.

9 I don't propose to address paragraph D, but there is  
 10 some evidence that the applicant will not treat the guiding  
 11 principles as a strong constraint. I just leave it at that,  
 12 subject to any further questions.

13 **CHAIR:** Thank you.

14 **MS CALLINAN:** At this stage I'd like to turn over to John Feil.

15 **CHAIR:** Could I just ask one question without belabouring it.  
 16 Again the assessment of the performance against the GPS  
 17 objectives in the Act, do you think that will, in the long  
 18 run, influence the applicant's behaviour?

19 **MS CALLINAN:** I think that undoubtedly the applicant's behaviour  
 20 will have to be measured against the GPS and we've already  
 21 talked about how effective that will be. But it is a  
 22 secondary and less direct check on behaviour. It's one layer  
 23 away from the day-to-day decision-making that will go on in  
 24 the industry working group and that's why we see it as a less  
 25 effective constraint than having the GPS properly reflected in  
 26 the guiding principles in the first place.

27 **MR FEIL:** I've been asked to deal with the issue of cost of  
 28 capital and throughout the application the Draft Determination  
 29 and subsequent submissions it's tended to be a bit of a moving  
 30 target. Initially this was proposed by the applicant as an  
 31 alternative way of deriving a number for the benefits and  
 32 detriment to the usual framework the Commission adopts.  
 33 However, when it came to the Draft Determination the  
 34 Commission seemed to have added another value to the equation  
 35 for a cost of capital; albeit a different number to the  
 36 applicant.

37 Now, if the Commission was considering this as a  
 38 different quantum for the same thing as the applicant, then we  
 39 would suggest that that misunderstood, or misinterpreted the  
 40 applicant's submission. The applicant's now suggested that a  
 41 change in cost of capital should be included as an additive  
 42 part of the Commission's framework. We don't see any basis  
 43 for that addition to the Commission's well-established  
 44 approach of working through efficiency gains and competitive  
 45 detriments.

46 The applicant, in its latest submissions, explained the  
 47 detriment was due to political risk. If this were to exist as  
 48 a matter of fact, we believe it's already accounted for in any  
 49 detriment assigned to the perceptions of decision-making  
 50 quality. To the extent that a Minister's involvement, and to

**Transpower (cont)**

1 take the applicant's caricature, causes problems under the  
2 counterfactual but operates perfectly under the proposal, then  
3 it's through that difference and the calculation and value  
4 assigned to it that the political risk impact should be taken  
5 into account. There's absolutely no need to account for it  
6 again.

7 Also in this regard it's appropriate to consider where  
8 political risk comes about. In the case of SOEs the nature of  
9 market regulation is significant. But, as the Commission  
10 suggested, there is some means of political involvement  
11 exerted through ownership. Although we would say that that is  
12 constrained by the operation of the SOE Act and the normal  
13 principles of how ministers exercise their shareholding.

14 That mechanism doesn't change between the proposal and  
15 the counterfactual. Unlike privately owned entities, the  
16 exposure of SOEs to political risk is not likely to be  
17 different where the proposal or the counterfactual is in  
18 place. We assume that something of this thinking was the  
19 reason behind the Commission's indication that a cost of  
20 capital effect was really only relevant to privately owned  
21 entities in the industry. But as we explained, in any event  
22 we think that changes to cost of capital shouldn't be included  
23 at all.

24 The second supposed reason for including a change in  
25 cost of capital is due to expected cashflows to industry  
26 parties. Generally we think that that sort of effect would be  
27 a transfer between industry participants, or between industry  
28 participants and other actors. Normally transfers are  
29 excluded from creating any net benefit or detriment to the  
30 economy on the principle that a dollar is a dollar,  
31 irrespective of who has it.

32 Also to the extent that reduced cashflow reflected a  
33 reduction in market power, we suspect that's better treated as  
34 a benefit than a detriment, to the extent that the  
35 counterfactual might drive monopoly rents to some degree out  
36 of the environment, then that's on the benefit side, not the  
37 detriment side.

38 As well as the theoretical problems we have with the  
39 notion of what the applicant suggests, we don't think it's at  
40 all safe to assess which side of the equation capital markets,  
41 that nice amorphous group of people, would come down on.  
42 You've certainly heard two distinct views of which is the more  
43 politically risky, which environment is more likely to see an  
44 over-intervention by the Crown.

45 One being we start with the industry EGB, if on our view  
46 and Bill Hogan's view that fails, you're not simply going to  
47 see a shift back to something equivalent to the Crown EGB. I  
48 think all the evidence, to the extent that's there from  
49 Professor Hogan and from the United States is, that you  
50 leapfrog to a much greater and much more heavy-handed

**Transpower (cont)**

1 intervention. So, it's not a matter of if it fails we move to  
 2 a Government EGB. If it fails the suggestion is you'll move  
 3 to something much more interventionist. To the extent the  
 4 capital markets understand that particular view and have  
 5 looked to the examples Professor Hogan's given, one might  
 6 think that those invisible actors in the capital markets might  
 7 well think that there's greater political risk associated with  
 8 that than with initially moving to a Crown EGB, certainly one  
 9 that we suggest is appropriate to the counterfactual.

10 In short in our view there is no reason for the  
 11 Commission to depart, or amend its usual framework for  
 12 analysis to include this additional factor.

13 **CHAIR:** Thank you, Nathan do you have any questions? Donal.

14 **MR CURTIN:** Just one quick one, just putting aside your point  
 15 about the transfer for a moment, let's assume it survives that  
 16 and is still in there as a line item. It's rare actually, I  
 17 think, for people to suggest that the sign might be different  
 18 on one of these things, that usually people are agreed on  
 19 whether it's a benefit or a detriment and we had, if I  
 20 remember Kay MacDonald, coming in and suggesting cost of  
 21 capital might be actually be lower under a Crown EGB for  
 22 everybody. So, obviously a wide variety of opinions.

23 Could a put a caricature in front of you maybe, if we  
 24 were thinking of looking at the impact of intrusive  
 25 Government, let's say, in the sector. Scenario A is  
 26 Government not terribly interested, there's essentially a  
 27 private market, people come in and make a buck and it's on  
 28 sort of normal commercial arrangements; caricature scenario B  
 29 is a country where the Government changes every three years,  
 30 there's a history of abrupt policy lurches from one direction  
 31 to another and governments have decided to take a very heavy  
 32 interest in this particular sector. I'm just wondering on the  
 33 face of it, if you didn't know more than that, which way would  
 34 you start thinking the cost of capital would go?

35 **MR FEIL:** In terms of adding in risk to the investments in the  
 36 particular country?

37 **MR CURTIN:** Mmm, if scenario A is Government not that interested,  
 38 and scenario B intrusive arbitrary Government.

39 **MR FEIL:** I think the answer to that depends on whether the  
 40 outcomes under option A or option B are acceptable to the  
 41 populace. If under option A the Government takes very little  
 42 interest but a number of years down the road the economy  
 43 grinds to a screaming halt and you thought that was going to  
 44 be likely, then you might well weight cost of capital and the  
 45 risk of investment in that country rather high.

46 If you thought that the intervention level at B was not  
 47 extreme, and was likely to be stable over a period of time,  
 48 then I would have thought that you might rate that as a lower  
 49 risk. But if you thought that option A was going to produce  
 50 perfect outcomes forever and a day you might go the other way.



*Transpower (cont)*

1           So, I don't think it's the nature of the intervention,  
2           it's the success of the intervention. I think that that's the  
3           approach that I would value the proposal and the  
4           counterfactual. If you think an industry EGB is going to  
5           continue forever happily, contrary to certainly our view and  
6           the certainly that Professor Hogan put to you, then you might  
7           come to the view that's better.

8           If however you think it's going to go to on for two or  
9           three years and the Minister's going to intervene, I think  
10          there's a strong case for saying the intervention won't simply  
11          bring you to where you might otherwise have been but take you  
12          beyond that, I think that gives you a different answer. So,  
13          I've tried to answer your question in the context I think  
14          that's appropriate.

15       **MR THOMSON:** Can I chip in practically? In the United States the  
16       cost of debt for new generation has gone up 2 to 3 percent.  
17       That's because of California and Enron equity failures.  
18       There's a number of merchant generators in the States that the  
19       equity's just fallen right out of bed and I'm very certain of  
20       that information, my daughter worked for CSFB Energy  
21       Investment Banking in New York.

22       **MR CURTIN:** I think what you're both saying is it's an empirical  
23       issue, there's no knock-out theory that says it should go  
24       either way?

25       **MR FEIL:** No, I don't think there is, I think you have to look at  
26       what outcomes you think are going to occur in what scenarios.

27       **MS REBSTOCK:** Can I just ask you, the comment you made on  
28       removing monopoly rents being a benefit rather than a  
29       detriment, you're not suggesting we factor that into the net  
30       benefit analysis, are you?

31       **MR FEIL:** I'm suggesting the best way of dealing with this is to  
32       not include cost of capital at all. I don't think you could  
33       be -- I think Nathan might wish to have a go at trying to  
34       estimate those, but I don't --

35       **MS REBSTOCK:** Even if you could, wouldn't you just say it's a  
36       redistribution?

37       **MR FEIL:** I think it would largely be a redistribution. It  
38       depends a bit on the elasticity. But I think it's going to be  
39       neither here nor there, I think you're better to stick to the  
40       original established approach.

41       **CHAIR:** Ms Callinan.

42       **MR FEIL:** I think it's still me.

43       **CHAIR:** You John is it? All right Mr Feil. I've also been asked  
44       to look at the submissions on transaction costs, compliance  
45       costs and lobbying costs which appear at page 26 of the book.  
46       I will be very brief. In short, we think that transaction  
47       costs exist whether you are looking at the proposal or the  
48       counterfactual. There certainly are costs to establishing and  
49       operating a Government EGB. There are costs in establishing  
50       and operating an industry EGB, but the comparison can't be at

**Transpower (cont)**

1 that level. You also have to add in the costs under an  
 2 industry EGB associated with the monitoring functions and the  
 3 advice functions that the Minister takes on board.

4 Initially there was a significant saving proposed, or  
 5 thought to exist, because the industry EGB was a much smaller  
 6 body took control and the Government's role seemed to be very  
 7 much on the laissez faire end of the chart. I think no matter  
 8 what your view of the counterfactual, it's quite clear now  
 9 that the proposal relies for its success, if it's going to  
 10 have success, on a monitoring role by the Minister, to a  
 11 reasonable extent on the role of the Auditor-General and the  
 12 Parliamentary Commissioner for the Environment. Those costs  
 13 need to be factored in.

14 The closer you bring, in our view, the role and  
 15 constraint and tension created by the Auditor-General and the  
 16 Minister's role and those other monitoring roles, including I  
 17 guess one for the Commission, the more you bring that to a  
 18 level where it equates its likely success to the operation of  
 19 a Crown EGB, we think that those costs come much closer  
 20 together and in fact to the extent you have multiple agencies  
 21 monitoring each other and operating under the proposal,  
 22 whereas you will have essentially one final agency under the  
 23 Crown EGB, there's even a possibility, if not a probability,  
 24 that at some point they cross-over and were you to be able to  
 25 get, were it possible for you to get to the same tension that  
 26 we think would operate successfully under the Crown EGB  
 27 through those alternative structures, you may well find that  
 28 the transaction costs are higher and the compliance costs are  
 29 higher, there is a point of cross-over. The more you move  
 30 down that track of course the less you get equivalence in  
 31 terms of their ability to actually monitor and control the  
 32 industry.

33 **MS REBSTOCK:** I find it hard to imagine that monitoring costs  
 34 could ever rise to meet the costs of actually being the cost  
 35 you incur when you have to make the decision.

36 **MR FEIL:** Sorry, I was not suggesting that monitoring costs  
 37 alone, the EGB plus the monitoring costs, if it were to be  
 38 equivalent in likely constraint on industry activity. So,  
 39 it's the totals that you need to compare, not just one element  
 40 or other.

41 **MS REBSTOCK:** I wonder about that, given the position that the  
 42 working party structure and everything would be quite similar  
 43 between the two. You know, whether that result actually does  
 44 hold.

45 **MR FEIL:** I think it depends on how much weight and  
 46 responsibility you put on to the monitoring role. My  
 47 impression from the applicant is that, at least initially,  
 48 they saw the Government being pretty hands-off on this. My  
 49 impression from the inquiries and questions from the  
 50 Commission is that you seem to suggest that there is actually

*Transpower (cont)*

1 quite an important role there. The more important that role  
2 is, the more expensive that role is.

3 **MS REBSTOCK:** I understand that point. But whether it could  
4 actually ever get to be the same amount is doubtful.

5 **MR FEIL:** I don't believe it can actually ever get to the point  
6 of offering an equivalent service to the public, so, I don't  
7 think that's likely. Lobbying costs is the final comment I'd  
8 make. I think we've all now had ample demonstration that  
9 lobbying is a feature. Whether you're lobbying the Minister  
10 as his monitoring an oversight role, or in his decision role;  
11 the only difference might be that the industry EGB will  
12 probably need a reasonably good lobbying interest to keep the  
13 Auditor-General and the Minister at arm's length. The Crown  
14 EGB probably will put that under a different heading.

15 **CHAIR:** I'm not quite sure what you mean "to keep the Auditor-  
16 General at arm's length you need to lobby", what do you mean  
17 by that?

18 **MR FEIL:** I think the way I would envisage that process of audit  
19 or effectiveness review operating would be that they would  
20 produce a draft, or the industry EGB would have a response to  
21 it. No matter what is reported to Parliament and to the  
22 Minister they would want a view, particularly if they  
23 disagree. So they will be engaging in lobbying, with a small  
24 L, in the same way as other parties. They will have an  
25 interest in reflecting their view of the Auditor-General's  
26 role and certainly their view to the Auditor-General on what  
27 his preliminary conclusions were. I think those are  
28 invariably part of either process.

29 The difficulty is that unless you take a reasonable view  
30 of what lobbying is, which is simply trying to influence  
31 another party, under one category it somehow disappears. I  
32 think in reality lobbying is a fact of life and is likely to  
33 exist at similar levels albeit with different titles and  
34 different parties.

35 **CHAIR:** It was put to us the other day that it's alternative  
36 policy advice, but that's another definition.

37 **MR FEIL:** I think that's one of the other definitions, yes.

38 **CHAIR:** On this one one would assume that once there had been  
39 performance standards agreed, once the Auditor-General had  
40 produced at least the first range of reports or report, then  
41 the rules at least for assessment should be reasonably  
42 settled, and that the industry just gets on with it.

43 **MR FEIL:** One might hope so. I'm not quite as optimistic and I  
44 think my colleagues aren't either about how objective rules  
45 that actually mean something might be developed. It's easy to  
46 develop, or relatively easy to develop objective rules  
47 relating to levels of activity. How many you do, how quickly  
48 you do them, as we all know it's quality rules that are much  
49 harder to develop. They're always open to interpretation. If  
50 you don't get the tick or cross that you want under one set of

**Transpower (cont)**

1 rules I don't think any party's likely to give up and say  
2 there shouldn't be additional criteria.

3 I really don't think the GPS is -- I think it's  
4 measurable in some ways. I think it's less measurable in  
5 others and to the extent there's a discontinuity between the  
6 Rulebook governing principles and the Crown governing  
7 principles, I think there's a debate and lobbying is involved  
8 in debate, as to which one should have primacy should the gaps  
9 be discounted as the industry would suggest, or is there  
10 invariably two or three items that have to be scored badly  
11 because they're not reflected in the rules.

12 **MR ROBERTSON:** Could I just add to that, apologies to any  
13 currently auditors present, there used to be a rule of thumb  
14 amongst auditors that materiality was defined by the size of  
15 the area divided by the number of days to deadline and that is  
16 a flippant way of perhaps expressing the point of view that  
17 attention starts to become very focused when the impact of the  
18 issue you're dealing with rises. I think what John's  
19 suggesting is that these issues, no matter what your views  
20 about the likely outcome, or the ability of the auditor to  
21 finally express a view, will be very seriously debated and  
22 engaged upon and the lobbying with the small L is really a  
23 manifestation of that.

24 **CHAIR:** Thank you. Ms Callinan please.

25 **MS CALLINAN:** I'd like to now move on to page 43 of the  
26 submission in relation to our submissions on the scope of  
27 authorisation. The applicant has sought authorisation of  
28 seven sets of provisions and there's no need for me to read  
29 them out. Each set of provisions was divided into primary  
30 provisions, secondary provisions and ancillary provisions and  
31 the applicant has sought to extend its application to cover  
32 giving effect to the voting arrangements.

33 Transpower's main concern is fairly straightforward. It  
34 is a concern that if the authorisation is granted then the  
35 scope of that authorisation should be clear. In relation to  
36 this, Transpower considers that the attempt to isolate  
37 specific provisions to be authorised was not very clear  
38 initially, ran the risk of leaving out some important  
39 provisions, and that had in fact proved to be the case as the  
40 voting provisions which are clearly integral to the  
41 arrangement, were not initially identified by the applicant.

42 Potentially other provisions that are not included in  
43 the specified provisions could raise similar issues. For  
44 example, definitions in annexure A are not included and so  
45 could be changed. But these are significant because they  
46 determine who is in each class of voters. Transpower  
47 considers that the only unambiguous way of ensuring that if an  
48 authorisation is granted, it is clear what is authorised, is  
49 to authorise the whole Rulebook. We have not attempted to go  
50 through the applicant's letter which tries to marry up the

**Transpower (cont)**

1 seven characteristics and the relevant rules in the Rulebook.  
2 We consider that to do so would be a very significant  
3 undertaking.

4 All we are highlighting is that if the Commission were  
5 to take the approach that the applicant suggests, then you  
6 would need to go through that process and be sure that there  
7 were no rules, or the allocation of the rules was right. That  
8 would be quite difficult and there's a risk that it would not  
9 be quite accurate. Clearly parts of the Rulebook -- so what  
10 we're suggesting is the more appropriate approach in order to  
11 gain clarity if there is an authorisation is that the whole  
12 Rulebook be authorised. Parts that are not complete, such as  
13 part B or the various ancillary arrangements, should not be  
14 authorised, and this would be consistent with the analysis of  
15 the Commission and I think indeed all the submitters, which  
16 has been of the Rulebook as a whole, rather than particular  
17 parts of it.

18 Alternatively if the Commission wishes to grant an  
19 authorisation that does not cover the Rulebook as a whole, it  
20 is important that the notice of authorisation clearly  
21 specifies what has been authorised. If it is not clear there  
22 will be significant costs for the industry in ascertaining  
23 whether a proposed rule change is within the scope of the  
24 authorisation or not.

25 As to a possible way to approach this, we just refer to  
26 the Commission's recent decision in relation to MACQS, where  
27 there was a quite careful analysis of parts of the arrangement  
28 that were and were not being authorised as a possible  
29 approach.

30 **CHAIR:** Thank you. Let's move on then.

31 **MS CALLINAN:** The next topic is guidelines for the amendments of  
32 the Rulebook. This is a procedural issue which we can deal  
33 with in reasonably short order. The applicant requested the  
34 Commission to provide some guidance under section 65 of the  
35 Commerce Act to assist the industry when it was considering  
36 the need for subsequent authorisation of future amendments to  
37 the Rulebook and the applicant has submitted some draft  
38 guidelines.

39 Transpower's position is that the guidelines should not  
40 be issued by the Commission, and the simple reason is this,  
41 that section 65 of the legislation already sets out the  
42 circumstances in which the Commission may revoke or amend an  
43 authorisation. This should be the guideline. Any attempt to  
44 paraphrase that guideline simply creates another level of  
45 complexity that would face anyone trying to figure out whether  
46 section 65 applied or not.

47 Just to highlight the potential complexity, we note in  
48 B(1), that under the Act the test is whether there has been a  
49 material change of circumstances since the authorisation was  
50 granted, or whether the change materially -- this is the

**Transpower (cont)**

1 proposed guidelines, whether the change materially changes the  
 2 facts on which the initial authorisation was based, or has a  
 3 significant impact on the basis of the arrangement is  
 4 initially authorised.

5 We note that the third guideline proposed by the  
 6 applicant simply doesn't add anything, because it says that an  
 7 authorisation is needed if a rule change breaches the law.  
 8 That's, of course, the current position. So, it's a  
 9 procedural point, but if the authorisation did go through, we  
 10 consider that that would not be helpful to have those  
 11 guidelines.

12 **CHAIR:** Section 65 is sufficient in your view?

13 **MS CALLINAN:** It is, it's just potential for uncertainty, if one  
 14 tries to paraphrase that, it may ultimately be unhelpful.

15 **CHAIR:** Thank you we'll move on then.

16 **MS CALLINAN:** The next topic that we'd like to deal with are the  
 17 conditions that the applicant has proposed to the arrangement.  
 18 The applicant proposed conditions in the letter of the 6th of  
 19 June and it has argued that it was procedurally appropriate  
 20 for the Commission to impose conditions, but did not  
 21 specifically address the substantive merits on the conditions  
 22 proposed.

23 We note that there is some other relevant submissions on  
 24 this that MEUG was also of the view that any proposal to vary  
 25 or extend the Rulebook should be treated as a new application.  
 26 MEUG objected to the Commission considering the proposed  
 27 conditions being considered at this late stage in the process.  
 28 MARIA has imposed different conditions and we don't propose to  
 29 deal with those.

30 Transpower has a number of points in relation to the  
 31 conditions. The proposal to give the rulings panel to the  
 32 power to override industry decisions is unlikely to promote  
 33 pro-competitive rules. This is because the ruling panel are  
 34 not substantive experts and not an appropriate body to have  
 35 decision-making power.

36 **CHAIR:** Just on that point before you move on, I think you would  
 37 have heard the chairman of the Market Surveillance Committee  
 38 some days back talking about the outcomes of that committee's  
 39 deliberations. Again, they're not an expert body. On the  
 40 other hand it's been difficult to see that they've been  
 41 anything less than fair and equitable in their decisions. I  
 42 think they've, I guess to use an analogy, hit parts of the  
 43 industry on the issue rather than who those parts are. So,  
 44 would you see the rulings panel not having that standing or  
 45 the ability to make decisions that the MSC currently has?

46 **MS CALLINAN:** I believe the rulings panel would be comparable to  
 47 the MSC in many respects. Certainly we're not suggesting that  
 48 the rulings panel would not be impartial, it has to exercise a  
 49 quasi-judicial role. Perhaps the point is, I do address this  
 50 point a little bit later on in the submission, if I could --

**Transpower (cont)**

1 **CHAIR:** We'll come to that when you do that.

2 **MS CALLINAN:** I can deal with it now, because it's a point that  
3 flows through the submission. We do have a problem with the  
4 conditions on a substantive level. It's really this point  
5 about the rulings panel. I deal with it on page 48. We say  
6 that the rulings panel is an inappropriate body to wield  
7 decision-making power because it is comparable to the MSC,  
8 it's designed primary as a judicial process orientated body,  
9 not a policy-making body, and so in that sense while it's  
10 multi-disciplinary it would not have the necessary industry  
11 expertise to make decisions. It's not truly independent to  
12 the extent it is appointed by the industry. It's also removed  
13 from the operation of the rules and so it's unlikely to make  
14 efficiency enhancing decisions. In our view it retains the  
15 worst aspects of industry decision-making without the supposed  
16 benefits of industry expertise or knowledge. So, we don't see  
17 referral to the rulings panel as any kind of substitute for a  
18 Crown EGB.

19 **CHAIR:** I just make one further comment and leave it I guess.  
20 The MSC is appointed by NZEM as I understand it, and while it  
21 has the same structural relationship, this is appointed by the  
22 industry. I don't think the MSC in practice has been  
23 criticised for making decisions that are obviously aimed at  
24 NZEM members as their sponsor, they've been taken as I see it  
25 independently and withstood that test of time.

26 **MS CALLINAN:** As I say, the main point we're making on this is  
27 that not so much the lack of independence, but it's the  
28 ability of the rulings panel to have the expertise to know how  
29 to make complex decisions in this industry.

30 **MS BATES:** Do you accept that the Market Surveillance Panel has  
31 that expertise or not?

32 **MR THOMSON:** No, not at the moment. Some of the decisions they  
33 make do not take full account of the practicalities of the  
34 power system, and that's not things that favour Transpower.  
35 That's things that favour generators. Sorry.

36 **MS BATES:** No no, I wanted to explore that, so what sort of body  
37 do you think would have the proper degree of expertise?

38 **MS CALLINAN:** I think the answer is the Crown EGB.

39 **MR THOMSON:** There's been a recent ruling on block dispatch which  
40 is horrible for everybody. I mean, we get it because as the  
41 system operator we administer the rules and everybody comes  
42 and tries to get us to fix the rules. It's under appeal but  
43 it's still not -- it's no good for the customers because the  
44 price is --

45 **CHAIR:** No no, but on the other hand all I'm trying to say, I  
46 think Denese is making the same point, it seems to me its  
47 reputation has been seen as being independent and objective.

48 **MR THOMSON:** Yep, got that.

49 **CHAIR:** There obviously will be times when any committee is going  
50 to make a substantive decision that may not be substantively

*Transpower (cont)*

1 correct for good reason rather than it not being independent,  
2 that's the point I'm getting at.

3 **MR FEIL:** Mr Chairman, if I may just offer one comment. I think  
4 the type of issue that would be before the rulings panel and  
5 the Market Surveillance Committee in its normal role as to  
6 whose complied with the rules, who hasn't, what is the  
7 consequence, who should be fined or sanctioned, are very  
8 different from the type of issue that would be before it when  
9 it was judging whether a particular proposed rule change  
10 should or should be granted or has been delayed unnecessarily.

11 I think one is very much a judgment within a framework  
12 where the rules are established and you hear from both sides.  
13 The other one I think is much more akin to policy making. It  
14 would be a bit like the Court writing the statute as opposed  
15 to interpreting it. I think the skills required -- I have  
16 absolutely no basis on which to say there's a bias problem in  
17 each situation -- but I think the skills information and  
18 incentives around those two sets of decisions are very  
19 different and to try and cobble them into one organisation  
20 would be somewhat difficult.

21 **MS BATES:** You theoretically could have a body with the proper  
22 degree of expertise deciding that, I don't see why you  
23 couldn't.

24 **MR FEIL:** I think the sets of expertise for the two roles could  
25 well be different. So, you either --

26 **MS BATES:** I do understand that but I --

27 **MR FEIL:** So you either come up with a compromised body, or you  
28 have separate bodies that are identified for each particular  
29 set of tasks. I think the second is better.

30 **MS BATES:** Why could you not have a body that had the people on  
31 it with the sufficient degree of industry expertise as well as  
32 the other skills which are necessary to make sure that proper  
33 decision-making is arrived at?

34 **MR FEIL:** I'd rather hope those people were running companies  
35 from the industry. I think you could, but I think in  
36 practical terms if you look at the skills that have been  
37 recruited to the Market Surveillance Panel, they are a  
38 different set of skills than you would expect on either the  
39 industry EGB or the Crown EGB.

40 **MS BATES:** Can you be a bit more specific?

41 **MR FEIL:** I think you would have more experience in policy design  
42 in the practical operations of the industry in developing  
43 rules; implementing rules, I think the skills in a judicial  
44 context, or an arbitration context are more valuable.

45 **MR THOMSON:** Another good example Bill's just pointed out to me,  
46 the Grid Security Committee is a policy making committee on  
47 top of a set of working groups. It is industry CEO's plus  
48 consumers' reps and it's different to the MSC which is more  
49 legalistic I suppose, and very neutral, don't get me wrong,  
50 they've been straight. But more into deciding about whether



**Transpower (cont)**

1 you've met something or not, not formulating the policy.  
 2 They're different types of people, rightly or wrongly. Like  
 3 somebody said, they're the ones that are running the companies  
 4 on the GSC that have got a fair idea of what's going on.

5 **MS BATES:** Where a decision has to be made amongst competing  
 6 interests, I don't see why you couldn't have a body that has a  
 7 requisite degree of technical expertise, but also the  
 8 decision-making ability that you get when you have some legal  
 9 representation on board.

10 **MS CALLINAN:** Can I just make a general point that the more  
 11 layers of decision-making you get within the industry EGB  
 12 proposal, the more duplication of effort you get. So, if you  
 13 have to have the Auditor-General and his staff completely up  
 14 to speed sufficiently to do a qualitative analysis of what's  
 15 going on in the industry, then you have to have the rulings  
 16 panel with a completely multi-disciplinary set of people  
 17 there. Presumably they would also need support in order to  
 18 tackle some of the complex issues coming out. You see my  
 19 point, we are getting whole other layers of costs, what we're  
 20 simply suggesting is it's better to have those costs residing  
 21 with the Crown EGB in the first instance.

22 That's the gist of the substantive issue that we had  
 23 with the conditions in relation to the rulings panel. But  
 24 while we're on that topic that also raises a procedural issue,  
 25 that we set out in paragraph 14.6, subparagraph (a). Because  
 26 the proposal that the rulings panel is able to make binding  
 27 decisions impacts, in our view, on almost every substantive  
 28 issue being considered. That is quite a different model from  
 29 the model that we've been discussing over the last few days.  
 30 In our view such a rule change would count act the applicant's  
 31 arguments on the merits of industry decision-making, and that  
 32 is very central to their position that industry decision-  
 33 making is seen as a benefit. So, simply from procedural  
 34 perspective we believe that this condition fundamentally  
 35 changes the shape of the proposal.

36 In paragraph B we just deal with another procedural  
 37 issue about the timing of when Transpower was made aware of  
 38 these conditions. The real issue is that the Commission was  
 39 not made aware of these conditions, or able to circulate them,  
 40 until the 6th of June and we suggest this may compromise the  
 41 Commission's ability to take account of those conditions and  
 42 seek sufficient input on them.

43 **CHAIR:** Just a question, the point was made to us yesterday that,  
 44 and this is not take ago view on the conditions, but it was  
 45 postulated if the conditions would in essence enable the  
 46 proposal to satisfy a wider range of interests, then let's get  
 47 on. You wouldn't agree with that?

48 **MS CALLINAN:** Well, I think that there are conditions and  
 49 conditions, in that Mr Thomson has set out quite clearly at  
 50 the outset Transpower's conditions in a different sense for

**Transpower (cont)**

1 entry into the Rulebook, so I think there is a fundamental  
2 difference of view between Transpower and this proposal, so  
3 that the conditions only take us so far.

4 **CHAIR:** All right thank you.

5 **MS CALLINAN:** Just one other point in 14.7(a) we just deal with  
6 the other part of the voting proposal in relation to the  
7 second vote, which was another aspect of the proposed  
8 condition. We are simply saying here that the second vote  
9 achieves nothing other than a further delay and there's not  
10 much reason to think that members would change their votes.

11 Turning over the page to page 48, I've already dealt  
12 with point 2, but the third point is it may -- removal of  
13 decision rights from industry parties may in fact act as a  
14 disincentive to join the Rulebook, and that might further  
15 endanger comprehensive coverage.

16 Point number (c), the applicant's own consultation  
17 process, and I refer here to a GWG paper, indicated serious  
18 concerns with the proposals, including that it was  
19 inconsistent with the guiding principles. It may invite  
20 increased lobbying to take advantage of concentrated interests  
21 and it carries increased risk of a rule change that materially  
22 financially disadvantages a member. If the condition is  
23 minor, as the applicant claims, then it's difficult to see how  
24 it could have sufficient impact on the net benefits to alter  
25 the Commission's decision. Even if there was some benefit in  
26 giving the rulings panel decision-making power, the Commission  
27 would then have to discount the applicant's claimed benefits  
28 of the industry having ultimate control.

29 I now turn to the second proposal which is extending the  
30 coverage of exemptions. I'm just conscious of the time, did  
31 you Mr Chair?

32 **CHAIR:** Well, I could stop now on the basis that would an hour  
33 and a half in the morning -- I've lost my --

34 **MS CALLINAN:** I certainly believe it would not take very much  
35 longer to complete what we have to say on conditions and in  
36 fact the benefits. If I had to give an estimate, another half  
37 an hour to 40 minutes at the most.

38 **CHAIR:** I suggest we might stop now, we'll reconvene at 9. I'm  
39 conscious of the applicant agreeing, if we can finish by  
40 10.30, Transpower that is, then you're happy to sum up in the  
41 afternoon or later that morning, and NZEM come in in the  
42 middle.

43 **MS BATES:** Could you just clarify, apart from finishing off with  
44 this, what matters you intend specifically addressing  
45 tomorrow?

46 **MS CALLINAN:** Two short matters. One is that Mr Sundakov will go  
47 through the overall summary of benefits and detriments and  
48 speak to the numbers in the NZIER report and the other is a  
49 very short summation by myself.

50 **MS BATES:** Do you have any of the papers available for us to read

**Transpower (cont)**

1 overnight?

2 **MS CALLINAN:** I do, the paper for the NZIER is in the appendix  
3 already?

4 **DR SUNDAKOV:** It's page 10.

5 **MS CALLINAN:** Page 10 and if it would be helpful I can put the  
6 summary out now, it's just a couple of pages.

7 **MR KOS:** I'd certainly appreciate that Mr Chairman.

8 **MS BATES:** I think it just might get us through tomorrow which  
9 will be a good thing I think.

10 **CHAIR:** Just again, I've got it wrong, I had it wrong before, but  
11 I'll try again. We'll have Transpower from 9.00 to 10.30 and  
12 then a break, NZEM 10.30 to 11, then I've got the applicant  
13 11.00 to 1.00, is that okay or do you want to start after  
14 lunch?

15 **MR KOS:** I think if we have all the material, Mr Chairman, we'll  
16 get going at 11.00.

17 **CHAIR:** All right, let's do that. Thanks Transpower, 9.00  
18 o'clock in the morning. Thank you.

19

20 **Hearing adjourned at 4.07 pm to 9.00 am**  
21 **on Friday 28 June 2002**

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