



MAJOR ELECTRICITY USERS' GROUP

8 December 2017

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Regulation Branch
Commerce Commission
By email to regulation.branch@comcom.govt.nz

Dear Keston

MEUG submission on draft Transpower capex input methodology decision

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commission draft decisions paper, Transpower capex input methodology review, 15 December 2017.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.
3. This submission has 4 sections. First an overview of MEUG's response followed by 3 topics of focus for MEUG:
 - Expected benefits and impact of proposed investments on transmission charges;
 - Incentive rates; and
 - E&D base capex demand adjustment mechanism.

Overview

4. The appendix to this paper summarises the topics considered in the decisions paper and MEUG's comments on each. The appendix considers changes to the Capex IM for:
 - Part 1 lists changes governing scrutiny of Transpower capital expenditure proposals,
 - Part 2 lists changes for incentives on Transpower to be efficient once ex ante settings are approved.
5. The 1st and 3rd focus topics noted in the opening section above are highlighted with yellow background in the appendix. The 2nd focus topic is a more general view on incentives.

¹ Document URL <http://www.comcom.govt.nz/dmsdocument/15874> at <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/transpower-input-methodologies/capex-input-methodology-review/>

Expected benefits and impact of proposed investments on transmission charges

6. MEUG supports the proposed new subpart 5 titled "Expected benefits and impact of proposed investments on transmission charges" in Part 7 titled "Information requirements applying to Transpower" that will apply to base capex, listed projects and major capex.
7. The non-exclusive list of measures of change in charges to consumers in cl.7.5.1(2)(d) should be expanded to encompass:
 - all customers of Transpower, ie generators as well as consumers;
 - Transpower charges at every GXP and GIP. This overcomes the problem that some EDB have multiple GXP over wide geographical areas or discontinuous networks and in the future transmission pricing a possible change to more granular and GXP and GIP specific. A shift to GXP and GIP specific services and performance measures is part of the improvements expected with the RCP3 IPP proposal. Coupling that greater granularity on service quality measurement with the effect on charges at individual GXP and GIP would deliver sharper estimates of future cost-reflective (price effect) and service-based (quality dimensions) of transmission pricing;
 - The time profile for changes in charges needs to be sufficiently long to allow customers and generators to use that information in their own investment decision making; and
 - A feasible range of possible changes in charges should be estimated.

Suggested changes to cl.7.5.1(2)(d) follow (text underlined proposed by MEUG):

"details of the forecast expected, and plausible high and low increase in transmission charges to consumers and generators due to the proposed investments, including estimated increases in-

- (i) transmission charges per kilowatt of demand;
- (ii) transmission charges per kilowatt hours of energy supplied; and
- (iii) transmission charges for each effected EDB, grid connected generator or direct connect consumer disaggregated by GXP and GIP.

The forecast changes in charges to be over a sufficient number of years to allow customers and generators to assess their investment decisions that may be dependent on or alternatives to the proposed investment."

8. MEUG notes that the information listed in cl.7.5.1(2)(d) is non-exclusive as sub-clauses (i) to (iii) are prefaced with the text "including estimated increase in". MEUG has been encouraged by Transpower estimating the effect on charges for recent major capex proposals and a willingness to further improve information to assist affected parties. MEUG intends continuing discussions with Transpower on how to give effect to the policy intent of better informing its customers and all end customers. For example, Transpower could publish the spreadsheet model used to estimate the effect on charges and thereby allow customers to test for themselves the sensitivity of scenarios important to them.

Incentive rates

9. The Commission states it broadly agrees with Transpower's view incentives can be relied on increasingly as regulatory arrangements mature.² MEUG also broadly agrees. The question is to what extent the regulatory arrangements have matured since the inaugural Capex IM and last RCP reset and therefore the extent to shift the balance of emphasis from up-front scrutinising and setting the ex-ante price-quality path to setting incentive rates to improve Transpower meeting the service expectations of customers as efficiently as possible.³
10. MEUG recognises Transpower has made improvements since the inaugural Capex IM and last RCP reset. However more progress is needed on aspects such as asset criticality and more granular coupling service quality measurement with the effect on charges at individual GXP and GIP before the primary focus on ex ante scrutiny can be shifted to tailoring incentives. If the ex-ante settings are not economically efficient and best practice, it will only be by chance that the incentives will restore outcomes to maximise the long-term benefit to consumers. MEUG therefore views ex ante scrutiny, particularly improving the suite of quality and output performance measures, rather than incentives as being more important in the near term.
11. To avoid any doubt MEUG fully supports the changes towards a "purer" ex ante regime. However, that change must be backed with more transparency to allow customers to be involved in the up-front scrutiny of proposals. Hence, our support for new subpart 5 of Part 5 discussed in the preceding section.
12. Paragraph 64 of the draft determination states
"We intend to continue to monitor the effectiveness of the regime and whether it is providing its intended benefits to consumers, both in terms of the incentive structure and the approval process for capex allowances over time. Ongoing monitoring will help inform decisions in future IM or capex IM reviews"
13. MEUG recommends that the Commission provide more details on timelines and how interested parties might be consulted and informed of progress. MEUG supports active monitoring and is not wedded to waiting for 6-years for the next IM review. The ability for the IM governing the regulation of Transpower, including the Capex IM, to be adaptable to possible major changes in the sector with emerging technologies (eg grid-scale batteries) and business models (eg possible emergence of distribution system operators) is important.

E&D base capex demand adjustment mechanism

14. MEUG supports the proposal to allow a demand adjustment mechanism for base capex enhancement and development proposals (E&P) to be specified in an IPP. This is not a trivial exercise. However, we think there will be benefits from considering forecast demand uncertainty across all E&D proposals in a consistent and integrated approach ahead of a RCP rather than in an ad hoc fashion during a RCP.

Yours sincerely



Ralph Matthes
Executive Director

² Draft decision, paragraph 44.

³ The 2-main functions of the Capex IM being up-front scrutiny and during a RCP the effect of incentives was explained in paragraph X9.2.

Appendix, Part 1: Scrutiny of investments before CC approval		
Category	CC draft determination proposals and analysis of proposals not accepted	MEUG response
• Overall capex approval process	“to require Transpower to report on its stakeholder engagement processes via changes to the ID requirements” ^{vi}	Support policy intention.
	“to pilot a verification process for the RCP3 reset” ⁱⁱ	Support a pilot programme.
• Base capex approval process	“introduce the option for a demand-based trigger for base capex E&D projects” ⁱⁱⁱ	Support.
	“require Transpower to provide an estimate of the change in transmission charges and an explanation of the system and service benefits delivered by each base capex proposal (Transpower would provide this information as part of its base capex proposal and its listed project applications)” ^{iv}	Support with suggested improvements to the draft determination.
	update the base capex qualitative information requirements in Schedule F ^v	Minor – no comment.
	“clarify that the requirements for assessing listed projects are those set out in Schedule A2” ^{vi}	Minor – no comment.
• Major capex approval process	“introduce a staged approval process for major capex projects” ^{vii}	Agreed.
	“provide the Commission with the ability to determine the major capex allowance, rather than approving Transpower’s proposal on an accept or reject basis” ^{viii}	Agreed.
	“remove the ability to amend the major capex allowance after its initial determination” ^{ix}	Agreed.
	“in the same way as we are proposing for base capex proposals, require Transpower to provide an estimate of the change in transmission charges and an explanation of the system and service benefits delivered by each proposed major capex investment” ^x	Support – see comments on same change for base capex approval process
	Major capex investment test issues considered by CC but rejected ^{xi} :	
	• inclusion of competition effects and option value. Proposed by CEN, TPW, MCY.	Agree with CC.
	• wider costs and benefits (including amenity value). Proposed by TPNZ.	Agree with CC.
	• Return of capital contributions. Proposed by CEN.	Agree with CC.
• Use of 7% discount rate. Proposed by MEUG.	CC response noted.	
• Consistency with the TPM. Proposed by TPW.	Agree with CC.	
Other major capex issues considered by CC but rejected:		
• Threshold for major projects ^{xii} . Proposed by CEN, TPW.	Agree with CC.	

Reference end notes are on the next page.

Abbreviations used for other submitters: CEN=Contact Energy, IEGA= Independent Electricity Generators Association

MCY=Mercury Energy, TPNZ=Transpower, TPW=Trustpower

Appendix, Part 2: Incentives on Transpower to be efficient once ex ante settings approved		
Category	CC draft determination proposals and analysis of proposals not accepted	MEUG response
• Base capex incentive rates	“apply one of two incentive rates for base capex projects, which would be a standard rate of 33%, and a low rate of 15% for large base capex projects that meet specified criteria” ^{xiii}	Support policy intention. No view on rates proposed for incentives.
	“change the basis of the base capex expenditure adjustment incentive from operating on the value of commissioned assets to operating on actual expenditure” ^{xiv}	Agreed.
	“remove the base capex policies and processes adjustment” ^{xv}	Agreed.
• Major capex incentive rates	“Change the major capex regime to an ex-ante framework by replacing two asymmetric ex-post incentive mechanisms (the major capex efficiency adjustment and the major capex overspend adjustment) with a single ex-ante symmetric mechanism (our proposed major capex expenditure adjustment)” ^{xvi}	Agreed.
	“define a 15% default incentive rate for major capex projects but to retain the ability to tailor the incentive rate for major capex projects in specific circumstances” ^{xvii}	Support policy intention. No view on rates proposed for incentive.
	Other incentive issues considered by CC but rejected:	
	<ul style="list-style-type: none"> Contracting with third parties^{xviii} Proposed by IEGA, CEN, MEUG, contrary views Orion, TPNZ Incentives for Transpower to complete major projects on time.^{xix} Proposed by MCY. 	Wait for Related Parties decision. Transpower Works Agreement discussions.

ⁱ Paragraph X25.2, discussed 258-280

ⁱⁱ Paragraph X25.1, discussed 231-253

ⁱⁱⁱ Paragraph X23.1, discussed 153-161

^{iv} Paragraph X23.2, discussed 286-292

^v Paragraph X23.3

^{vi} Paragraph X23.4

^{vii} Paragraph X24.1, discussed 204-230

^{viii} Paragraph X24.2, discussed 84-91

^{ix} Paragraph X24.3

^x Paragraph X24.4

^{xi} Paragraphs 163-188

^{xii} Paragraphs 196-199

^{xiii} Paragraph X22.3, discussed 108-130

^{xiv} Paragraph X22.4, discussed 143-152

^{xv} Paragraph X22.5

^{xvi} Paragraph X22.1, discussed 68-86

^{xvii} Paragraph X22.2, discussed 92-106

^{xviii} Paragraph 189-195

^{xix} Paragraph 200