Powerco Limited

CORPORATE OFFICE
84 Liardet Street
Private Bag 2061
New Plymouth
T 0800 769 372
F +64 6 758 6818
www.powerco.co.nz

11 July 2014

Paolo Ryan
Commerce Commission
PO Box 2351
WELLINGTON 6140

[Sent by email to: regulation.branch@comcom.govt.nz]

POWERCO

Dear Paolo

RE: Cross submission on Setting Transpower's Individual Price-Quality Path

Thank you for the opportunity to make a cross submission on the Draft Decision Paper*: Setting Transpower's Individual Price-Quality Path* (the Draft Decision Paper).

We have considered the submissions published on your website and wish to make the following points.

Timing and treatment of efficiency gains

Powerco recognises the value of the type of expenditure challenges used to assess Transpower's IPP application. However, in our view, any resulting adjustments to capex or opex forecasts should be supported by a clear rationale. It is inappropriate to apply blanket reductions to broad areas such as corporate opex without a well argued justification.

The sharing of efficiency savings between consumers and service providers is an essential feature of effective incentives established under the Part 4 regulatory regime. As noted by Transpower and Vector in their submissions, the manner in which the Commission has, in effect, proposed to anticipate efficiency gains before those gains have been, or can be, made reduces the power of the regime's incentives (most notably the IRIS mechanism). This approach, if retained, would greatly reduce the scope for genuine efficiency gains to be achieved during RCP2.

We also note that it is usually best for efficiency savings to occur gradually over a regulatory period if the expenditure reductions are to be genuine, measured, and consistent with the regime's incentive objectives.

In brief, we support Vector's and Transpower's submissions in this area.

Draft decision on proposed grid expenditure reduction

The draft decision proposes a significant reduction to Transpower's grid capex forecasts. The Commission, with advice from Strata, has proposed reductions to Transpower's replacement and refurbishment (R&R) and enhancement and development (E&D) expenditures. We discuss both of these below.

R&R Expenditure

The Commission has indicated that it will accept Transpower's proposal for an incentive mechanism that links an asset health measure to its R&R expenditure on transmission lines and AC substation portfolios.

We agree that the use of such a mechanism is appropriate (in these circumstances) and do not agree that the Commission's proposed 5% expenditure reduction should be pursued.

E&D Expenditure
Powerco considers that the consumer engagement undertaken by Transpower to support this expenditure[1] was generally positive and is reflected in the content of their proposed projects. We also support the further review work and response Transpower has provided on the Commission's comments on its demand forecasting, needs identification and options analysis.

Transpower's response to the Commission's draft decision notes that it is concerned that the significantly reduced total E&D allowance ($67M) creates a risk that it will not be able to keep up with the expenditure required to maintain appropriate levels of utilisation, security and reliability on the grid. This will potentially create a backlog of projects deferred into RCP3 and thereby introduce further delay to a number of projects of similar merit and justification that are already tentatively scheduled in this period. There are constraints and security issues affecting some of Powerco's important supply points, and we recognise that the funding allowed does not yet permit Transpower to address these. We would be concerned if work to address these issues were further delayed due to a severely restricted funding base in RCP2. We would support Transpower's revised total expenditure of $99M as more appropriate from s long term perspective.

We would also endorse Transpower's comments that the nature of its business means it is difficult to predict the changes to demand and generation, and therefore the specific projects of highest merit, at the time an IPP is prepared. In principle, the quantum of expenditure needs to be appropriate, recognising long term trends, with allowance provided to substitute within a portfolio of projects and flexibility granted to alter the scope, timing and options associated with particular projects, including the option to delay or eliminate some projects.

Proposed Transpower capex E&D projects within Powerco's network coverage area

We support Transpower's IPP proposal with respect to the two base capex E&D projects within our network coverage area, specifically "Bunnythorpe interconnection capacity" (PD36), and the "North Taranaki transmission capacity" (PD37). The need case for these projects appears strong with the existing or pending exceedance of the N-1 criterion in relation to the core grid 220/110kV interconnection transformers (ICTs). Upgrades are therefore required in order to meet the Grid Reliability Standards. Project timing and option selection may need further refinement, but these appear to have been optimally assessed alongside renewal requirements, reliability risks, demand expectations and the proposals of major customers.

Transpower's proposed solution for the North Taranaki transmission capacity project (POD37) establishes an appropriate long term development path. Benefits we see from adopting this development path are:

- Adequate future capacity for demand growth;
- Support for additional generation in North Taranaki;
- Rationalising the grid configuration recognizes that the original driver for 220kV in New Plymouth is now redundant with the decommissioning of the power station;
- Support for any potential economic development of the land at the Port;
- Avoidance of high future renewal and maintenance costs associated with the EHV switchgear at New Plymouth and the associated highly corrosive coastal environment.

Powerco is still in discussion with Transpower concerning the possibility of alternate supply to our Moturoa substation, which is necessary to enable New Plymouth GXP to be dis-established. New 33kV cables from Carrington St GXP, as proposed in POD37, is one option being investigated. Our understanding is that Transpower would fund these cables. We believe Transpower's estimate of $5M is an appropriate order of magnitude, although estimation is not yet complete.

[1] This view also applies to Transpower's proposed service performance measures.

The Strata recommendation to defer the North Taranaki Transmission Capacity project (PD37) into RCP3 may be inappropriate. We agree with Strata that there are certain anomalies and deficiencies in the documentation, particularly as originally submitted, but see the needs case as clearly established. Consequently, we believe a solution in RCP2 is warranted, albeit that the options should be further explored.

Summary
In conclusion, Powerco considers that the grid capex challenge process has sharpened the transmission expenditure forecasts and that the Commission should now accept Transpower's revised proposals.

Proposed reduction in insurance expenditure and corporate opex
The Commission has applied a 10% reduction to Transpower's proposed insurance expenditure and its corporate opex. No reasoning is provided to justify the 10% proposed reduction figure for insurance. If Transpower can demonstrate that it undertakes an appropriate process to secure insurance cover, we believe the full amount should be allowed. The alternative could lead to negative outcomes, i.e. the purchase of inappropriately low insurance cover. The rationale supporting the substantial reduction in corporate opex also appears limited and, to some degree, inconsistent.

As a general comment, the Commission's application of blanket reductions, with limited justification and analysis, is concerning to Powerco. Powerco is considering applying for a customized price-quality path (CPP) and will make an application if it believes this is in the best interests of its consumers. The potential use of the approach applied to Transpower's IPP creates unnecessary uncertainty for distributors, and may delay CPP applications that would otherwise be made.

The cost of indemnities for quality of service under the Consumer Guarantees Act
As an electricity distributor, Powerco is also affected by the changes to the Consumer Guarantees Act and agrees with Transpower's assessment of this issue. The current regulatory regime does not account for this uncertainty and the potentially large liability associated with a major service disruption, which a supplier company may have very limited or no capacity to control. If the Commission is not willing to make amendments to allow indemnity obligations associated with the Consumer Guarantees Act to be recoverable costs, as proposed by Transpower, then the Commission should consider the two alternatives suggested by Transpower.

Thank you for considering the points made in this cross-submission.

Yours sincerely

Richard Fletcher
General Manager, Regulation and Government Affairs