

14 June 2017

Keston Ruxton
Manager, EAD Regulation Development
Regulation Branch
Commerce Commission
Via email: regulation.branch@comcom.govt.nz

Dear Keston,

Consultation Paper – Transpower Capex IM review

Mercury welcomes the opportunity to comment on the Transpower capex input methodology review. No part of our submission is confidential.

Market development

Mercury supports focusing on new opportunities which could benefit from emerging technology and believes this is clearly the key opportunity facing the electricity sector. New technologies and innovation provides scope to transform participants and consumers' relationship to energy services. It is crucial that consumers benefit from competition which starts by ensuring New Zealand maintains a level playing field where all technologies compete on an equal basis.

Access to relevant transmission augmentation opportunities and associated data is an important issue. We are pleased Transpower is open to providing sufficient information to all interested participants as to opportunities to provide support for the grid. This will enable multiple solutions to be proposed and the most cost effective and fit for purpose option selected.

Given the changing landscape in the energy sector, are there adjustments that could be made to the capex IM to better ensure the right transmission investments are being made, including non-transmission solutions?

Mercury welcomes the view from Transpower (at the knowledge sharing workshop) that a dollar spent is a dollar spent and that the key to the spending decision is the long term return on the spend. It should not be considered against the benefit it provides to the regulated business (through direct or related party transactions) but rather at greatest net benefit it provides for consumers.

We agree with the Commission that it is easier to quantify transmission prices than wholesale and/or retail market behaviours. However more consideration should be given to market impacts. For example, consider a transmission upgrade delivering extra capacity into a power importing region with expensive local sources of generation. Under the current Capex IM's investment test, the investment can be considered to generate savings in fuel costs owing to reduced generation from the high cost sources in the importing region. However, the investment may also deliver market benefits in terms of reduced wholesale market pivotal pricing power and increased retail competition in the importing region.

Considering these benefits will require making an assessment on wholesale and/or retail market impacts which are valuable consumer benefits. We also note that the Capex IM's investment test already allows for consideration of competition effects which could include some of the aforementioned market impacts.



Does the capex IM support a proportionate approach to scrutiny?

Mercury is of the view that it does support a proportionate approach to scrutiny. The way in which Transpower is required to consider options and consult on all major capex proposals is crucial to establishing confidence that investment decisions are made for the long term benefit of consumers.

Once expenditure has been approved, does the capex IM appropriately deal with changing circumstances?

We agree that the Capex IM should incentivise and assist Transpower to efficiently deal with changing circumstances. The deferral of aspects of the Lower South Island Renewables/Clutha Upper Waitaki Lines Project pending further generation commitment and/or load retirement as a good example of this working in practice. We would support changes to the Capex IM to reduce “compliance costs” on Transpower for making such decisions, subject to maintaining transparency to market participants about the reasons for amending an investment decision.

We are also supportive of Transpower having an increased opportunity and/or flexibility to undertake works that confer real option value (We note that the current Capex IM’s investment test specifically identifies real option value as a class of cost or benefit.) The uncertain landscape in the energy sector suggests that a staged sequence of smaller projects to meet an evolving transmission need could be more beneficial for consumers than the approval of a single large project.

We also favour mechanisms that allow Transpower to undertake “enabling works” and more detailed analyses of options before committing to a major build.

Are the incentive mechanisms in the capex IM effective?

Mercury is of the view that there are insufficient incentives in the capex IM for the Transpower to complete major projects “on time”.

Mercury has observed that market participants who have invested significant capital to dovetail with Transpower projects (be they investments in industrial projects, generation projects, electricity derivative trading positions and/or electricity retail positions) have on occasion been disadvantaged as timeframes have not been met. There does not appear to be any current incentive (penalty) for Transpower projects to be completed within previously agreed project timeframes.

While there is a clear Commerce Commission focus on keeping projects within budget, Mercury is of the view that projects need to be assessed against an on time/on budget criteria.

Mercury acknowledges that the projects delivered do provide an overall market benefit however delays in realising these benefits (against what had originally been assessed) can cause significant financial impacts to participants.

We also note that Transpower is currently consulting on proposed RCP3 service performance measures. As an electricity generator we consider that while security of supply to load centres commensurate with the value and quantum of such loads is of vital importance, connectivity at critical generation sites on the grid should be given some priority as part of future service measures. Mercury supports greater stratification of performance measures for generation sites, in line with our past comments on Transpower’s RCP2 measures.

During the consultation on RCP2 measures we observed that many generation connection locations, particularly those on the 220 kV grid and/or interconnected grid, enjoy a high level of transmission security via multiple circuits and bus couplers. We felt that performance targets could therefore be relatively ambitious for these connection locations, scaling downwards as the level of redundancy decreased.

Our more recent thinking has been guided by the criticality of generation sites for the operation of the grid. Connected capacity could be one such guide for the importance of a generation site. Poor connection performance at larger generation sites could be weighted more heavily in an overall generation site performance measure. This is reasonable as the loss of connection of a large generation site poses an increased risk to the reliable operation of the power system while also increasing wholesale market costs.

For example, multiple loss of connection events at Maraetai and Waipapa in recent years have led to the System Operator giving serious consideration to classifying aggregate generation across the two sites as a Contingent Event risk, raising the prospect of additional reserves being procured from the wholesale market to



manage a perceived reduced level of reliability. Mercury supports incentives on the Grid Owner to drive behaviours that proactively address such issues as they emerge.

Mercury also supports a performance measure incentivising smart approaches to transmission outage planning that minimise the aggregate market costs of losses and constraints on the transmission grid resulting from outages. Such performance measures could initially be applied to key grid backbone circuits.

Multiple outages on a transmission asset could be reduced if work at each “end” of the asset could be performed simultaneously, thereby reducing the aggregate quantum of losses and constraints.

Outage planning should also consider as a matter of course the dynamics of demand and fuel availability on the grid. For example, the conventional wisdom is generally to plan large transmission outages for low demand periods such as summertime or weekends. However this is not necessarily economic for parts of the grid such as the Wairakei Ring where large quantities of renewable, must-run generation sites are located. In this case the costs to New Zealand of spilled fuel could be reduced through planning outages for periods where local supply and demand are better matched, whilst also taking into consideration the costs and benefits to the wider grid of the outage window.

Are aspects of the capex IM too complex and prescriptive?

Mercury is of the view that the capex IM is not too complex or prescriptive. Mercury is however concerned that there is a separate regime for participants who essentially deliver a similar service to the broader market participant group as well as consumers (that is, to keep the lights on). Mercury encourages greater consistency between the 2 regimes, particularly sound investment decisions based upon broad market benefits and transparent reporting of financial transactions and opportunities for services for monopoly service support.

Please contact Buddhika Rajapakse, Trading Analytics Team Leader, (Buddhika.Rajapakse@mercury.co.nz or 09 308 8223) if you wish to discuss any details of our responses further.

Yours sincerely



Nick Wilson
Manager Regulatory and Government Affairs

