Major Electricity Users' Group

7 March 2019

Dane Gunnell
Manager, Price-quality Regulation (Acting)
Regulation Branch
Commerce Commission
By email to regulation.branch@comcom.govt.nz

Dear Dane

Transpower's IPP Issues paper – cross-submission

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) on the submissions of the 7-other parties that commented on the Commerce Commission issues paper "Transpower's individual price-quality path for the next regulatory control period" (IPP for next RCP), dated 7th February 2018.[1]

2. MEUG members have been consulted in the preparation of this cross-submission. This cross-submission is not confidential. Some members may make separate cross-submissions.

Key points

3. Transpower has earned excessive rents in RCP2.

4. Transpower has failed to provide the information necessary to allow evaluation of improvements arising from their expenditure.

5. Transpower has failed to take a customer or consumer-centric approach to its engagement and positioning, rather has sought to justify or position itself for continued excessive future rents.

6. The Commission should be especially mindful of not creating adverse incentives or rewarding behaviour that has not demonstrably led to improvements for its customers, including EDB and direct connect major users.

7. RCP3 costs should be lower than RCP2 costs.

Quality incentives

8. Attached and to be read as part of this submission is a memorandum from Mike Hensen of NZIER commenting on Transpower's submission in relation to quality incentives.

9. The Transpower submission did not provide any new quantitative information on how the revenue at risk is supposed to encourage improved performance and therefore does not provide a basis for extending the comments made in the previous NZIER report on the

[1] https://comcom.govt.nz/regulated-industries/electricity-lines/electricity-transmission/transpowers-price-quality-path/setting-transpowers-price-quality-path-from-2020

Issues paper. This is a barrier to interested parties to testing the price quality trade-offs implied by the proposal.

10. NZIER have also pointed out that a key issue for planned outages, the management of risk created by planned grid outages that coincide with other events that constrain energy supply, is not on the table for consideration.

11. MEUG agrees with the submission of Vector (p2) that "we (Vector) do have concerns about the potential for revenue linked asset health measures to reward Transpower for routine expenditure on assets, particularly where improvements already incentivised through the service performance measures." Vector then recommend "The Commission should be mindful that it does not reward Transpower for routine expenditure of 'double-count' rewards when it sets incentives."

As we don't know if incentives to date have worked, how can we know if Transpower's proposed RCP3 package will be an improvement and proportionate?

12. MEUG supports the submission of Meridian Energy (pages 1 to 5) under the section titled "Submission – Commission must analyse how Transpower has responded to incentives". We have summarised Meridian's argument as follows. If we, that is end consumers, Transpower's customers and the Commission, don't know if the incentives to date have worked, how can we know if Transpower's proposed RCP3 package will be an improvement? And if the proposed changes are headed in the right direction, is the mix of price and quality path proposed along with incentives/penalties proportionate to achieve outcomes consistent with the purpose of Part 4 given this milestone once every 5-years opportunity to do so?

13. As an aside we welcome Meridian's inclusion of Chart 1 in their submission illustrating Transpower's ROI compared to the estimated return (67th percentile WACC) for the three years to date of RCP2. This supports the point made in our submission that Transpower has been earning excessive rents. As discussed in the submission by Meridian, we don't know if those excess economic returns reflect clear efficiency gains as a result of innovative changes adopted by Transpower or not.

Talk of wanting Non-Transmission Solutions to be considered is not followed through with action to provide a commercial framework to allow NTS providers to build a business case

14. MEUG supports the submission of the Independent Electricity Generators Association (IEGA) to lift the priority by which Transpower establishes a workable framework for potential Non-Transmission Service (NTS) providers to build a business case to offer and negotiate NTS contracts with Transpower. Over the last year Transpower consultation on major capex and listed projects includes Requests for Information on potential NTS. We question if that is effective given potential NTS providers have no certainty on the contract terms and conditions they would need to consider making a price-quantity offer given Transpower haven't completed preparing with interested parties standard form contracts?[2] Until Transpower gives certainty on what terms and conditions they will contract for NTS under different time-frames (e.g. length of contract term and notice period for delivery), quality (e.g. possible variable levels of reliability or a probabilistic rather than deterministic approach to quantity contracted) and price structure (e.g. on delivery or with a stand-by payment) there is a barrier to potential NTS providers investing in processes and expertise to make well-considered offers.

[2] Transpower's submission also mentions (p12) "and we recently communicated outcomes to stakeholders from consultations on our processes for transmission alternatives." That communication did not give MEUG any confidence Transpower was giving development of a viable NTS market a high priority.

15. To avoid any misunderstanding MEUG does not necessarily agree with the following two specific parts of the IEGA submission (both in last bullet point, p2):

    a) "ensuring distributed generation contracted as an alternative to transmission investment is compensated on the same basis as Transpower's transmission assets for the life of the investment"; and

    b) "In addition, a peak demand price signal is important to signal the upcoming need for more capacity"

16. The above are questions to be considered in further negotiations between Transpower and interested parties or fall within the remit of the Electricity Authority in terms of default transmission contract terms and contracts of which transmission tariff design consistent with the TPM guidelines is an important component.

NTS contracted services are a subset of the wider opportunities that new technologies, more cost reflective prices and new business models might provide to improve outcomes for consumers that Transpower needs a more open and inclusive engagement on

17. MEUG has been disappointed with the quality of engagement by Transpower over the last year on the wider opportunities that new technologies, more cost reflective prices and new business models might provide to improve outcomes for consumers. This may come as a surprise to Transpower and others as they and many parties point to Te Mauri Hiko as a flagship piece of thinking as part of the debate on what and how to transition to a low carbon economy.

18. There is a contrary view that Te Mauri Hiko was a self-serving piece of work to give greater weight to a scenario where the grid must expand in the future. Compared to all other recent forecasts of electricity demand Te Mauri Hiko is an upper bound outlier. As noted in the previous section there is a perception Transpower talks the talk but does not walk the talk to facilitate development of a viable NTS market and hence undermines options that may decrease reliance on grid expansion.

19. Evidence that Transpower needs to be more open and lift its game in terms of being more inclusive on future opportunities and risks includes the submission from Wellington Electricity Lines Limited (p3) "WELL is concerned that Transpower has not consulted with electricity distribution businesses (EDBs) on their strategy for integrating disruptive technology, like local distribution, electric vehicle batteries and local storage into their network".

20. MEUG would qualify any support for WELL's concern by adding the caveat that any lift in consultation by Transpower with EDB such as WELL should include consumers, retailers and aggregators that have or may have an interest in contracting services to either or both local EDB and Transpower.

If RCP3 is a holding position before clarity on RCP4 onwards is realised, then costs should fall

21. MEUG is not convinced by the submission of Transpower in section 9.1 titled "Asset Management and Operations portfolio staffing strategy" in response to the Commission's question that while the proposed FTE level in the AM&O portfolio remains constant and the base level opex for the portfolio reflects historical spend, it is considering whether Transpower's shift in focus from an organisation that undertakes major capex works to one that maintains and renews its network requires constant FTE levels. MEUG members' experience and our observations of other capital-intensive enterprises, including large generator-retailers, is that enterprises expand and contract with investment cycles. Given RCP3 is a holding position with little major capex and there is uncertainty on how RCP4

and RCP beyond that may play out, then resource needs and costs for RCP3 should fall relative to RCP2.

22. As noted in the preceding section we are dubious of the motives around Transpower's promotion of the upper bound range of demand forecasts in Te Mauri Hiko. The demand for new transmission capex in RCP4 and beyond may be modest if optimal policy settings are put in place including the effective and timely establishment of NTS and non-Distribution Service markets and non-contracted demand side management to cost-reflective line charges by engaged consumers.

23. In addition, recall the point in paragraph 8 above that we don't know if the excess economic returns to date in RCP2 reflect clear efficiency gains as a result of innovative changes adopted by Transpower or not. If there have been efficiency gains over RCP2 to justify earning excess profits, then RCP3 and all future RCP costs should reflect those efficiencies with lower costs than RCP2.[3]

Accountability through RCP3

24. MEUG supports the offer in the Transpower submission (p3 and repeated on p8) that "we would welcome a regular, qualitative engagement during RCP3 to ensure we keep the Commission and our stakeholders informed of our improvement plans" with 3 caveats:

    a) The dates should be specified in the IPP determination to avoid any misunderstanding on what "regular engagement" means and to ensure performance on the final RCP3 determination is the focus.

       Transpower submitted (p12) that engagement in RCP2 has included "convening industry forums three to four times per year". This is a misleading statement. Few and usually none of those forums had an agenda item on Transpower's performance and accountability to date against the RCP2 settings. Rather, they have either been system operator related, specific grid owner technical forums or to consider specific regional topics.[4]

    b) The engagement should be on quantitative as well as qualitative factors; and

    c) The engagement should be part of a broader engagement plan that must be in place and published before RCP3 begins. Transpower refer to such a plan on p8 "We are developing detailed plans for engaging with our customers and stakeholders during RCP3, including our Consumer Advisory Panel." Having a plan in place before RCP3 commences is critical if we are to hold Transpower accountable for actual progress over RCP3 on a regular basis.

Yours sincerely

Ralph Matthes
Executive Director

[3] If evidence is found that excessive profits in RCP2 to date are not matched with clear efficiency gains, that leads to a wider debate on the efficacy of the current regime.
[4] Refer https://www.transpower.co.nz/system-operator/stakeholder-interaction/industry-workshops