PO Box 10742, Wellington
Level 2, Harbour City Tower
29 Brandon Street
Wellington, New Zealand
contactenergy.co.nz

14 June 2017

Keston Ruxton
Manager, EAD Regulation Development
Regulation Branch

By email: regulation.branch@comcom.govt.nz

Dear Keston

Transpower Capex IM Review

Introduction

Thank you for the invitation to contribute to the Commerce Commission's (**Commission**) review of the Transpower capital expenditure input methodology (**capex IM review**).

Contact supports regulatory settings which promote the long term interests of consumers. To this end, we welcome the opportunity to comment on the capex IM, particularly with regards to emerging technologies,[1] and Transpower's ability to appropriately incorporate, and optimise such technology into its operations. We outline below our views on the proposed areas of focus for the capex IM review, and offer some suggestions for key issues to be addressed.

Focus area 1: 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?

Yes. At present, the regulatory investment test (**RIT**) only applies to growth capex with a value greater than $20m (classified as "major capex"). In these circumstances Transpower is required to look at non-transmission alternatives.

Contact is concerned that, at present, the RIT only captures approximately 20% of Tranpower's capex and suggests it should be extended to cover a greater proportion. Over the 5 years of regulatory control period (**RCP**) 2, major capex has equated to approximately $300M, which therefore misses the bulk of the non-transmission opportunity.

We note in Australia the RIT has historically only applied to "growth" capex. However, in April 2017 the Australian Energy Market Commission (**AEMC**) published a draft rule determination[2] to extend the RIT to replacement and refurbishment capex. Contact would encourage the Commission to consider the same extension.

Focus area 2: Does the capex IM support a proportionate approach to scrutiny?

No. Contact considers the $20M threshold for base capex projects is too high.

[1] Emerging technology is taken to include (but not be limited to) solar photovoltaics, batteries, demand response, electric vehicles and associated infrastructure, and other new energy technologies which can be provided by a competitive market.
2 http://www.aemc.gov.au/getattachment/89cd54cf-d5c5-4bc7-b406-f05f595ae26a/Draft-rule-determination.aspx.

By way of contrast, in Australia this level is set at $6M, and hence a far greater proportion of expenditure is captured through the test. On balance, Transpower's threshold should be lower than in Australia (given projects will generally be smaller in nature) so as to capture a similar amount of expenditure under the test.

We also note that the Australian Energy Council (**AEC**) recently submitted a rule change request to the AEMC which included to *"lower the regulatory investment test for distribution (**RIT-D**) threshold to $50,000, with some form of shortened RIT-D process applying to these investments"*.[3] The rationale for the rule change request included "*this lower threshold of $50,000 is set to capture activities such as distribution substation (transformer) upgrades where either small scale or BTM (behind the meter) generation or storage may represent an equivalent technical and superior financial alternative to any asset upgrade"*.[4] We note that distribution networks in Australia commonly operate 132kV and 66kV infrastructure, and hence the rule change request applies to similar assets to those included in Transpower's network which includes 110kV and 66kV lines and substations. Further, the AEC also commented that "*we consider that distribution networks are broadly analogous to transmission networks, and consequently include consideration of Chapter 6A in our rule change proposal*".[5]

Focus area 3: Once expenditure has been approved, does the capex IM appropriately deal with changing circumstances?

It's not clear from the capex IM review consultation paper how Transpower may adequately respond to changing circumstances. Contact considers creating the right incentives for Transpower to be able to substitute capex for opex will be of critical importance. For example, if 4 years into RCP3 a third party solution emerges as more efficient than a capex solution, Transpower's capex IM must have the flexibility to substitute that option.

Focus area 4: Are the incentive mechanisms in the capex IM effective?

We believe a review of whether the incentive mechanisms in the capex IM are effective needs to be undertaken as part of a broader assessment of other factors which may influence Transpower's decision making in relation to capex or opex-based solutions. Contact has previously raised[6] that "*new technologies and business models are expected to bring significant benefits to consumers of energy services*", and that this should "*substantially change how dynamic efficiency is considered with regard to cost of capital settings*".

Focus area 5: Are aspects of the capex IM too complex and prescriptive?

Yes. Complexity aside, Contact would like to see more flexibility in various aspects of the capex IM. Of particular interest would be the opportunity to formally input into the grid investment test (**GIT**), and the integrated transmission plan prior to its publication. We are concerned that, for example, the GIT accounts for fuel costs only but does not factor in the price separation effect that cannot be managed or resolved in the market. We would like to see consideration given to market constraints in regions of the grid where a net pivotal situation prevails.

Contact would also welcome more flexibility in the capex IM to enable partial funding of major capex projects (if it can be broken down) by participants, so that projects can be brought forward. At present there is no way to recover that funding once the project does pass the GIT and is approved on an economic or reliability basis. Transpower can only recover the total cost less the partial funding

---

[3] Page 11, AEMC National Electricity Amendment (Contestability of energy services) Rule 2016 consultation paper

[4] Page 7, AEC rule change request to the AEMC, 13 October 2016

[5] Page 2, AEC rule change request to the AEMC, 13 October 2016

[6] Page 38, Contact Energy submission to Commerce Commission on IM review draft decision, 4 August 2016

amount, as this is the amount that goes into the RAB. We would welcome further analysis of how private investment could be more efficiently incorporated into major capex projects, and how any timing issues on Transpower's RAB recovery could be resolved.

Suggested other areas of focus:

a) Limitation of the scope of the RIT

The capex IM review paper notes that "in proposing major capex under the capex IM, Transpower must assess the likely costs and benefits of different investment options for all participants in the electricity market".[7] We would like assurance that this only relates to the Transpower investment in monopoly lines infrastructure. If applied to competitive infrastructure like battery storage, we believe this requirement has the potential to distort Transpower's RAB, and harm competitive markets. It's foreseeable that, for example, Transpower may consider a network scale battery and include it in its assessment all revenue that can obtain from providing distribution and wholesale services – and thus essentially competing in what should be competitive markets with a regulated asset.

Contact considers that due to current regulations which allow Transpower to include competitive infrastructure in the RAB, Transpower should only be able to consider *transmission* benefits in its investment test, and not include the benefits of broader services (in competitive markets) that batteries and other emerging technologies can access. This would support a developing network services market whereby entities operating in a competitive environment strive to optimise the value a network scale battery can obtain, and as a result compete to lower the cost of network services the battery can provide Transpower, to the benefit of all electricity consumers.

b) Demand response programme and grid support contracts

When a Transpower investment test process results in a third party non-transmission solution being selected, our understanding is that the third party would be awarded a grid support contract (**GSC**). Transpower has also developed a demand response program which awards demand response agreements (**DRA**) to third party suppliers. Whilst we appreciate that the two schemes/contracts have different objectives (including GSCs contracting for a longer term, firm non-transmission solution, and DRAs contracting for a shorter term, non-firm transmission solution), Contact would appreciate clarification on how Transpower intends to utilise both programs, the interaction between them, and the capex IM investment test process.

Summary

In considering whether to make amendments to Transpower's capex IM, Contact considers several of the Commission's key focus areas warrant further analysis. Of particular importance will be to create regulation that is flexible, durable, and offers certainty for all market participants, and to encourage services at a quality that reflects consumer demand, distribute efficiency gains with consumers, and limit the extraction of excessive profits. We also welcome the opportunity to comment further on how the rapid development of new technologies (since the previous RCP) has changed the playing field, and created more options to better promote outcomes for consumers by leveraging innovation and competitive markets.

---

[7] Para 162, Commerce Commission capex IM review consultation paper.

We look forward to continuing to engage with the Commission on the capex IM review.

Yours sincerely,

David Gendall
Legal Counsel & Regulatory Advisor