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Keston Ruxton
Manager, EAD Regulation Development
Regulation Branch
Commerce Commission
P O Box 2351
Wellington 6140

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

Dear Keston,

RE: Transpower capex input methodology review – Emerging views on incentive mechanisms

Pioneer Energy Limited (Pioneer) appreciates the opportunity to make submissions on the Commerce Commission's (Commission) emerging views on the incentive mechanisms in the Transpower Capital Expenditure Input Methodology.

Pioneer is a member of the Independent Electricity Generator Association and supports its submission.

The Commission is seeking feedback on two aspects of the incentive framework[1]:

a. the incentives affecting major capex appear to provide limited incentive for delivering efficient capex spend – in particular the use of an ex-post efficiency adjustment for major capex; and
b. the potential disincentive for Transpower to undertake transmission alternatives (and, in particular, procure network services from third party providers) in instances when they may be the most efficient solutions.

Our understanding of the proposed solutions and our feedback is detailed below.

a. Major capex efficiency incentives

At a high level the Commission's proposed solution appears to be:

i. one ex-ante symmetric incentive mechanism for major capex that uses a framework consistent with the base capex regime[2]
ii. a move from approval of a P90 estimate of expenditure to a P50 estimate[3]

[1] Source: http://www.comcom.govt.nz/dmsdocument/15710 From paragraph 15 in the consultation paper
[2] Ibid. Discussed in paragraphs 26 to 31

iii. potential for different incentive rates for different projects[4]

iv. introduction of an option within the capex IM to go through a staged approval process before the final costs and completion date are approved by the Commission[5]

Pioneer's feedback on this proposed solution is focused on the option of introducing a staged approval process (ie. iv. above).

Pioneer strongly supports including the option for a staged approval process. As we said in our submission[6] on the proposed focus areas:

> "We support a staged approach to infrastructure investment. A staged approach is more likely to result in no-regrets investment and better enable transmission alternatives to be a real option to meet an identified need but where there is uncertainty about how this need might develop over time."

A staged approval process makes sense for the reasons identified by the Commission. Approving expenditure in a staged manner is also highly relevant for the other topic of transmission alternatives.

b. Incentives and engagement on transmission alternatives

At a high level the Commission's proposed solution appears to be:

i. introduction of additional engagement requirements on Transpower for certain types of capex projects and programmes. This could be related to longer-term planning and/or specific projects that fall under the $20 million threshold[7]

ii. Transpower would have the discretion to decide the level of engagement for projects below a cost threshold of $5 million[8]

Pioneer supports the proposed solution. The proposed additional engagement processes, and a staged approach to approval, will enhance the ability of:

- third parties to understand how they might contribute to deferring or avoiding transmission investment leading to investment in transmission alternatives; and
- Transpower to access and assess information about potential transmission alternatives at an early stage so that long-term grid planning can incorporate efficient transmission alternatives.

For clarity, the additional engagement requirement should apply to any type of transmission investment – whether it is replacement, refurbishment or enhancement projects.

Transpower's Transmission Planning Report (TPR) is a comprehensive informative description of the state of the transmission grid and identified upcoming issues and is regularly updated. In Pioneer's view the additional engagement process might involve more publicity about the upcoming issues from the TPR before Transpower

[3] Ibid. Discussed in paragraphs 32 to 33
[4] Ibid. Discussed in paragraphs 34 to 37
[5] Ibid. Discussed in paragraphs 38 to 42
[6] See http://www.comcom.govt.nz/dmsdocument/15535
[7] Ibid. Discussed in paragraphs 67 to 71
[8] Ibid. Discussed in paragraphs 72 to 73

begins the process of identifying / analysing / costing solutions that then end up in an application to the Commission for investment approval.

Pioneer suggests Transpower undertake an annual offer to contract for distributed generation and demand response at GXPs in the transmission region being considered for an investment. This annual process could, for example, be an annual auction seeking proposals from third parties whose investment/s would be required to meet a targeted volume of alternative capacity (in aggregate or individually) if called.

Contracting for transmission alternatives

The Commission has not indicated if it is considering the issue of contracting for transmission alternatives as it progresses this capex IM review.

Pioneer raised issues regarding contracting for transmission alternatives in its submission[9] on proposed focus areas. MEUG's cross submission[10] on the proposed focus areas provides a useful summary of the level of interest in the regulatory form of contracting for transmission alternatives.

Pioneer suggests Transpower be required to offer all parties whose tenders are accepted (in the auction mentioned above) a rolling 10 year contract that can be called in any year under the terms of the offer. That is, Transpower has the option to extend the contract with a particular third party every year and the term of the contract is always 10 years from that date.

We suggest Transpower should be required to accept all the offers that meet their criteria and achieve the incremental growth in capacity that is required to meet Transpower's planning standards. The standards and cost revealed by these contracts should be equivalent to the standards and costs that Transpower would require from a transmission asset investment – making Transpower indifferent to transmission alternatives.

This contract would provide Transpower with certainty about the additional capacity for a minimum of 10 years plus the life of the investment if the option is exercised. The third party investor in the transmission alternative would have sufficient time to ensure the additional capacity is available for Transpower when it is needed and have income certainty for the life of the investment if the investment achieves the requirements in the contract with Transpower.

Our suggestions above are initial thoughts and require more work, or consultation. We would welcome the opportunity to discuss this with you in more detail.

Yours sincerely

Fraser Jonker
Chief Executive

[9] See http://www.comcom.govt.nz/dmsdocument/15535
[10] See http://www.comcom.govt.nz/dmsdocument/15568