MAJOR ELECTRICITY USERS' GROUP

10 March 2014

Paolo Ryan
Commerce Commission

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

Dear Paolo

Transpower RCP2 cross-submission

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) in relation to the Commerce Commission issues paper[1] "Invitation to have your say on Transpower's individual price-quality path and proposal for the next regulatory control period" dated 10th February 2014.

2. This cross-submission is not confidential.

3. MEUG agrees with the submissions of Carter Holt Harvey and Meridian Energy Ltd. The latter suggested various strategies to improve forecasting and management of annual wash-ups, and introducing some market impact and other measures into the revenue-linked regime in RCP2. Meridian make a useful point in stating:

   > "We think the Commission should consider revenue-linking these measures (even if revenue at stake is low) in order to ensure there is some incentive on Transpower to achieve the proposed targets (noting in some cases targets would need to be set)."

4. Transpower (s. 3.4, p12) in commenting on the Commission's statement that the "proposal is relatively weak on the customer service related measures" submitted:

   > "A comparison with overseas jurisdictions (the UK is referenced as an example) is likely to include regulatory regimes with more developed incentive regimes and customer-service mechanisms. Our proposed Other Measures represent a first implementation of such a regime in New Zealand which will mature over time."

[1] http://www.comcom.govt.nz/dmsdocument/11469 found at http://www.comcom.govt.nz/regulated-industries/electricity/electricity-transmission/transpower-individual-price-quality-regulation/transpowers-price-quality-path-from-2015-to-2020/

5. We suggest the Commission consider Transpower's precautionary approach in case there are unintended consequences from advancing or adopting a leap-frog approach to one aspect of the IPP and not others. Equally the Commission needs to consider the outcome if we fail to accelerate the incentives on Transpower to improve its productivity. On balance we think the onus falls on Transpower to demonstrate there are downsides in having more not less measures in the revenue-linked basket. Meridian's suggestion of using a low value of revenue at risk approach in RCP2 for some of these measures may be the way forward.

6. Observations on aspects of the submission by Transpower follow:

   a) The diagrams in the appendix are helpful but omit one important feature. That is at the start of a reset period Transpower may be below best frontier or even "average" efficiency of comparable line service companies. Figure 4 in Transpower's submission is replicated with an additional curve to illustrate Transpower costs in the initial regulatory period are above that of an efficient business. The inefficiency gap is shaded red. In the example below it is assumed by the end of the initial regulatory period Transpower will have reached the level of an efficient comparable business and hence the red dotted line, representing an efficient business also matches Transpower's actual performance.

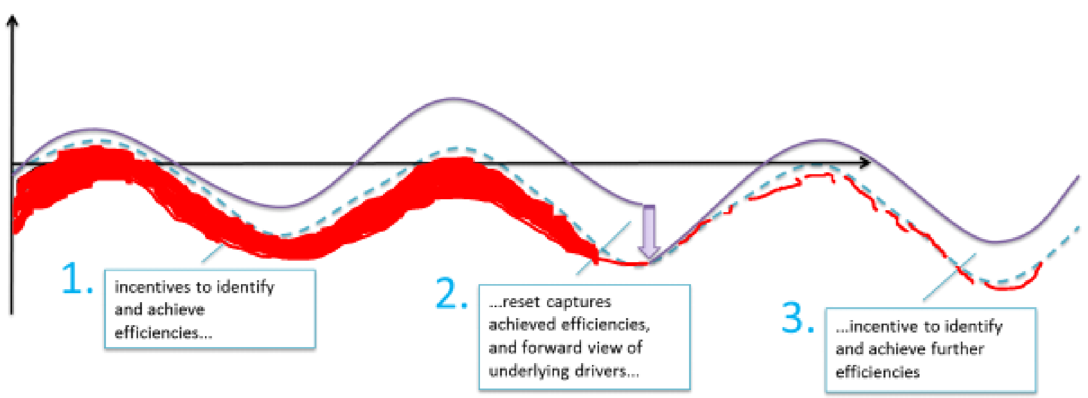

Figure 4: Stylised representation of reset process capturing revealed efficiencies and forecast fluctuations

   The question arises as to why customers of Transpower should pay costs, including cost of capital, between the efficient level and the current actual inefficient level of Transpower? It would be bizarre if the incentive regime resulted in Transpower earning above WACC while the productivity of Transpower was below best or frontier levels.

   b) S2.3 (p3) states there will be "a reduction in Base Capex of more than 10% compared to RCP1." MEUG is unsure if this statement takes into account the six large re-conductoring projects with an aggregate cost in excess of $120m. The Commission's review needs to check if Transpower's proposal with all proposed capex counted will lead to aggregate capex decreasing as claimed.

   c) There is a helpful discussion on more details of the options for managing ex ante approval of large re-conductoring projects in section 4.7.1, pages 16-17. MEUG's response to Q.20 in the Commission issues paper indicated we were not convinced a change from the status quo was needed and as an alternative suggested a shorter IPP period be set to allow time for better information to reduce uncertainty on forecasting costs for these large re-conductoring projects. In light of Transpower's submission our view is now that we are open to considering all options including those put forward by Transpower, an allowance for contingent expenditure, plus shortening the IPP period.

d) The discussion on demand response (pages18-19) provides information on the expected scale of ongoing work at approximately $2m per year. Still missing are "details[2] of the proposed work programme" and "how that expenditure links with service delivery and compliments or not other work by Transpower" noted in MEUG's response to Q.19 of the Commissions' issues paper. Without that information we remain unable to take a view on whether the $2m per year demand response should be part of base capex, a recoverable item or under a new "allowance for contingent expenditure" category.

Yours sincerely

Ralph Matthes
Executive Director

[2] For example it is unclear if the $2m per year is a fixed overhead cost irrespective of demand response implemented to reduce other transmission costs or an estimate of variable costs that are project specific and hence can then be allocated to those individual projects.