

Submission to the Commerce Commission
on the
Transpower Process and Recommendation
Discussion Paper

Made on Behalf of
18 Electricity Distribution Businesses

31 July 2009

Submission on the Transpower Process and Recommendation Discussion Paper

A revised regulatory regime for electricity lines businesses (ELBs), gas pipeline businesses (GPBs) and major international airports came into effect on 14 October 2008, with some provisions for ELBs delayed until 1 April 2009, via a new Part 4 of the Commerce Act 1986 (the Act). The Commerce Commission (the Commission) is required to recommend to the Minister of Commerce how Transpower New Zealand Limited (Transpower) should be regulated under the new provisions of the Act once its current administrative settlement with the Commission expires on 30 June 2011.

Accordingly the Commission has released a Discussion Paper: *Transpower Process and Recommendation Discussion Paper, 19 June 2009* (the Discussion Paper), which sets out its preliminary views on the regulatory provisions relating to Transpower and the type of price-quality regulation that should apply.

This paper forms our submission on the Discussion Paper which has been prepared by PricewaterhouseCoopers on behalf of the following 18 Electricity Distribution Businesses (EDBs):

- Alpine Energy Limited
- Aurora Energy Limited
- Buller Electricity Limited
- Eastland Network Limited
- Electricity Ashburton Limited
- Electricity Invercargill Limited
- Horizon Energy Distribution Limited
- MainPower New Zealand Limited
- Marlborough Lines Limited
- Nelson Electricity Limited
- Network Tasman Limited
- Northpower Limited
- OtagoNet Joint Venture
- The Lines Company
- The Power Company Limited
- Top Energy Limited
- Waipa Networks Limited
- Westpower Limited.

This group of EDBs together comprises 486,504 connections (or 25% of the total electricity distribution sector), 62,099 system kilometres (or 43% of the total electricity distribution sector) and \$2.2 billion dollars of regulated network fixed assets (or 30% of the total electricity distribution sector).¹ The ownership structures represented include consumer and community trusts, a listed company, local body and co-operative ownership, as well as those managed by management companies. Group members include networks with predominantly urban systems, others that are sparsely populated and a number with significant urban areas combined with rural and remote rural characteristics. These EDBs are customers of Transpower and therefore have a direct interest in the prices charged for their transmission services and the quality of the services provided by them.

Our Submission

1 The current Administrative Settlement between Transpower and the Commission will expire on 30 June 2011. This provides for price-quality regulation of Transpower up to that date. Prior to 30 June 2011 new regulatory provisions must be developed following a recommendation from the Commission to the Minister of Commerce as to the type of price/quality regulation to apply to Transpower. Transpower will also continue to be subject to information disclosure regulation although this form of regulation is not the topic of the Discussion Paper.

Statutory Framework

2 We support the interpretation that the purpose of default/customised price-quality regulation (DPP/ CPP) is relevant for setting individual price-quality regulation. We agree that the objectives of customised price-quality regulation are similar to individual price-quality regulation in the Act although the provisions for individual price-quality regulation are less prescriptive than for DPPs and CPPs. This is appropriate as DPPs are anticipated to be a relatively low cost regulatory instrument to be applied to a number of regulated businesses within a sector, with the option for customised terms to address business specific circumstances. Individual price-quality regulation by default is designed around business specific circumstances.

3 We agree with the Commission's interpretation that section 52K provides useful Guidance as to the information that should be contained in the recommendation to the Minister, including the input methodologies which should apply. We also agree that other provisions in relation to

¹ Based on 2008 Information Disclosure Data

inquiries (such as the consultation provisions in section 52J) are also relevant for this recommendation.

4 It is important for the Commission to provide sufficient detail to the Minister supporting its recommendation. This should include sufficient information about the recommended option and also the alternatives considered. Paragraph 2.26 of the Discussion Paper suggests the Commission is intending to provide details regarding either the DPP or the material provisions to apply to individual price-quality regulation as part of its recommendation. It is not clear from the Discussion Paper to what extent these details would include both options or would be limited to the Commission's recommended option. We suggest that as a minimum the recommendation should include the detailed provisions for the recommended option supported by a clear description of the alternative and the major differences between them.

5 The Discussion Paper proposes that input methodologies would be determined for Transpower prior to the recommendation to the Minister with the exception of the input methodology covering matters relating to proposals by a regulated supplier for a customised price-quality path. This exception is due to the Commission's preference for individual price-quality regulation rather than DPP/ CPP regulation for Transpower. We support the intention to determine input methodologies prior to the recommendation. We believe however that the input methodology relating to the CPP option is an important component of understanding that option. We also note that the CPP input methodology for EDBs and GPBs will have been consulted upon and determined by the target date of 30 June 2010 thus providing a platform on which to base the methodology for Transpower.

6 We note the reference to information disclosure regulation applying to Transpower. We also note that the current information disclosure requirements for Transpower have been in place effectively unchanged (other than minor amendments) since 1999. New information disclosure requirements published in 2008 introduced significant changes for EDBs but not Transpower. These are long overdue for review and we encourage the Commission to progress this work stream as quickly as possible and look forward to contributing to that consultation process in due course. Once input methodologies have been determined and the final recommendation to the Minister has been made in mid 2010, information disclosure requirements for Transpower should be able to be developed immediately in parallel with the Commission's draft determination in the latter half of 2010.

Proposed Process

- 7 We generally support the process set out for making the recommendation to the Minister on the type of price-quality regulation to apply to Transpower. Specifically we support:
- Developing the input methodologies to apply prior to the recommendation, as noted previously
 - Making the recommendation prior to the expiry of the existing administrative settlement
 - Inclusion of 12 month transitional price-quality requirements based on the existing administrative settlement agreement to allow for the new regulatory requirements to be developed and implemented and Transpower to develop better forecasting models.
- 8 We note that the timetable set out in Table 3.1 of the Discussion Paper proposes a draft recommendation for submissions in Q1 of 2010. We encourage the Commission to include as much detail as possible in this consultation round consistent with our submission on the reset of the DPP for EDBs.² It is not possible for interested parties to be able to respond in a meaningful way unless the proposals are expressed in sufficient detail.
- 9 We also note that the proposed process for setting the new price-quality regulations to apply to Transpower from 1 July 2012 includes a review of expenditure. We note that the form of regulation to apply to Transpower encompasses both price and quality. There is very little mention of the quality component of price-quality regulation in the Discussion Paper, other than reference to the requirement in the Act for quality standards in a DPP or CPP to give effect to the quality standards set by the Electricity Commission. The Commission nevertheless must consider how to set price in the context of the quality standards which will apply. We would expect explicit consideration of this issue in the determination of the new price-quality requirements to apply to Transpower and note that it is currently effectively absent from the proposed process.
- 10 In addition we note that there is no reference to the section 54Q requirements in the Act. Section 54Q requires the Commission to promote incentives and avoid disincentives for suppliers of electricity lines services to invest in energy efficiency and demand side

² PricewaterhouseCoopers, Submission to the Commerce Commission, on the Reset of Default Price-Quality Path for Electricity Distribution Businesses Discussion Paper, Made on Behalf of 18 Electricity Distribution Businesses, 17 July 2009

management and to reduce energy losses. We believe this is a serious oversight and that there is an explicit requirement in the Act for this issue to be addressed in the recommendation to the Minister and the new price-quality regulation that eventually applies to Transpower.

- 11 Finally we note the Commission's plans to develop Enforcement Guidelines for breaches of price-quality paths for EDBs (as set out in the DPP Reset Discussion Paper). This reflects the new and amended penalty, compensation and offence provisions applying to regulation of ELBs under the Act. Similar Guidelines will be required for Transpower, and as for the EDBs, we suggest that these should be made available prior to the new regulatory requirements coming into force.

Proposed Type of Regulation

- 12 We agree with and support the Commission's intention to have regard to the 2006 GPS (which addressed investment incentives for regulated infrastructure) and the 2009 GPS (which addressed security of supply).
- 13 We support Transpower's view that a DPP is difficult to establish for them given Transpower has no direct domestic comparators on which to base default requirements. The low cost objectives of the DPP are therefore unlikely to be met given the unique characteristics of Transpower and the need to accommodate these in the form of regulation to apply to them. Accordingly we support further consideration of the individual price-quality option and in particular the potential advantages this may have from a development and compliance perspective when compared with the DPP/PPP option.
- 14 We also acknowledge that individual and customised price-quality regulation provides more flexibility in accommodating lumpy investment profiles. However the latter would first require the establishment of a DPP which would appear to be superfluous if it was envisaged at the outset that customised terms would be required to provide the necessary flexibility.
- 15 The Discussion Paper indicates that individual price-quality regulation is the least prescriptive of the options provided for in the Act. This provides for a significant degree of flexibility and the ability to consider a number of options. As noted above we believe that this requires careful consideration of not only the input methodologies, which are currently subject to widespread and detailed consultation, but quality of supply and energy efficiency incentives and disincentives.

- 16 In our submission on the DPP Reset for EDBs we supported further consideration of incentive mechanisms in price-quality regulation for EDBs.³ This also should apply to Transpower and they should not be limited to incentives for cost and price efficiency.
- 17 We agree that the full building blocks approach proposed will allow the Commission to include the impact of ex-post reviews and provides the Commission more flexibility in its timing than a CPP does.
- 18 We are concerned however that the Discussion Paper includes a considerable amount of detail about the full building blocks approach for determining the revenue requirement for the price component of the price-quality path. This is consistent with the input methodology consultations published at the same time. This level of detail and thinking only addresses one part of the regulatory equation as noted above.
- 19 The significant amount of investment currently being undertaken and forecast for the transmission grid over the next few years suggests that prices will rise if a full building blocks approach is applied. It is reasonable to expect that supply quality will also change, particularly given the constraints which are currently evident across the grid and the frequent breaches of the quality thresholds reported by Transpower in recent years. It is to be hoped that the planned investments will address this propensity to fail to meet the existing quality standards. Historical reliability standards however may not be an appropriate basis for setting the quality component of the price-quality regulation to apply to Transpower. We look forward to further consultation on this important topic before the recommendation is made to the Minister on the form of price-quality regulation to apply to Transpower.

Answers to the Discussion Paper Questions

Q.1) Do you consider that the Commission should hold a session at the input methodologies conference to discuss this Discussion paper in September 2009?

Yes, given the timetable set out in Table 3.1 in the Discussion Paper there is no further opportunity for a conference on this topic. We support the Commission's objectives in respect to conferences as set out in paragraphs 1.18 and 1.19 of the Discussion Paper.

³ supra n2 page 5

- Q.2) Do you agree that all input methodologies applicable to the regulation of Transpower should be determined prior to the Commission making its recommendation to the Minister? If not, which input methodologies do you consider should be determined before the Commission makes its recommendation, and why?**

Yes, refer paragraph 5 above.

- Q.3) Do you agree that the Commission is not required to determine input methodologies for a customised price-quality path at the time of making its recommendation, if the Commission recommends that individual price-quality regulation should apply to Transpower?**

No, refer paragraph 5 above.

- Q.4) What other matters should the Commission consider when developing the process for the regulation of Transpower under Part 4 of the Act?**

As noted in paragraphs 8 and 9 above, the level of detail to be provided to interested parties, the explicit consideration of the relationship between price and quality and energy efficiency and disincentives which may be embodied in the new form of regulation to be recommended to the Minister.

- Q.5) Do you agree with the Commission's proposed process for making the recommendation to the Minister and making the s 52P determination? If not, what changes do you consider should be made and why?**

Yes, refer paragraph 7 above.

- Q.6) Do you agree with the Commission's preliminary view that a full building blocks type analysis, including expenditure review is required to recognise Transpower's revenue requirement? If not what type of analysis should be undertaken to set Transpower's price-quality path, and why?**

Yes, but this only determines a revenue path consistent with underlying quality reflected in the agreed investment programme. It does not address incentives for quality improvement consistent with consumer demands or energy efficiency initiatives.

Q.7) Do you agree with the Commission’s preliminary view that individual price-quality regulation would be more suitable for Transpower than default/customised price-quality regulation? If not, why should default/customised price-quality regulation apply?

Yes, however the advantages and disadvantages compared to the DPP/PPP option must be articulated and if possible quantified for consultation purposes.

General

The primary contact for this submission is:

Lynne Taylor
Director
PricewaterhouseCoopers
lynne.taylor@nz.pwc.com
(09) 355 8573