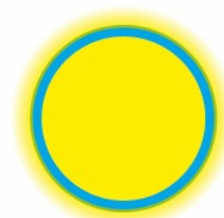


25 May 2010

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POWERCO



Dear Alex

Powerco Submission on 2010/11 Non-Part F Capital Expenditure Threshold for Transpower

Introduction

1. Powerco welcomes the opportunity to comment on the Commerce Commission's (the Commission) paper on the *2010/11 Non-Part F Capital Expenditure Threshold for Transpower* (the Paper), published on 12 May 2010. Investment in transmission is vital to support New Zealand's economy and growth in productivity. This goal is recognised by the Commission in its Paper, and by numerous Government publications. It is important that the Commission's decisions incentivise investment.
2. As the Commission summarises in paragraph 5, non-part F expenditure consists of capital expenditure on replacement, refurbishment, enhancement and development (RRE), and operation network information and technology services (IST). Transpower proposed non-part F expenditure for 2010/11 of \$246m. Strata Energy Consulting (Strata) recommended that the threshold be set at \$210.3m. The Commission has proposed a level of \$225.6m. The Commission's proposed reductions are as follows:
 - 5% based on an assumption that this amount of work will be rolled-over to 2011/12;
 - 1-2% as an incentive to contain costs by improved targeting and monitoring; and
 - 5% based on an assumption that this degree of efficiency can be made on projects as they complete the approval process.
3. Powerco's main concern is the evidence base that these reductions are based on. There seems to be little analysis of what is reasonable.

Historical expenditure is one of the factors in assessing deliverability

4. The Commission states that, "Transpower's improved performance supports a threshold higher than historical average spend, but its history of under-delivering to its business plan and capital forecasts suggests that it would be appropriate to set a lower threshold than Transpower proposes". The Commission has placed greater weight on more recent performance. Powerco notes that historical performance is only one factor in assessing deliverability.

Avoid the uncertainty of an ex-post mechanism

5. The Commission states that the Transpower settlement provides for an ex post review by which Transpower can gain approvals for additional capital expenditure and enter approved and commissioned assets into its asset base.¹ Powerco supports Transpower's comment that this mechanism should only have to be used in exceptional circumstances. While the Commission can increase certainty by setting out the process for ex-post approvals in more detail, this will not eliminate the risk entirely. Powerco supports an approach where an ex post mechanism is rarely used, and welcomes the Commission's efforts to improve the transparency of how the ex-post mechanism would work.

5% deduction for rollovers

6. The Commission has agreed with Strata that it is appropriate to make an adjustment to the proposed threshold to take into account projects that are likely to be rolled into the subsequent year. The Commission has also agreed with Strata to adopt a 5% adjustment for RRE and IST on the basis that this amount of work is likely to be deferred to the next regulation period. Powerco is unclear what the quantifiable justification is for this deduction. There seems to be no analysis of what figure is appropriate, if at all.

5% efficiency deduction on unapproved projects

7. The Commission has not required 100% of projects to have completed the internal approval process in order to be included in the threshold. The Commission considers that it is reasonable to assume that projects will be able to be reduced, on average, by 5% by going through the approval process. Powerco supports Transpower's statement that the rationale supporting this deduction is unclear and very subjective. The project approval process may in fact increase the costs of a project, as the project is better defined and costs become more apparent.

1-2% cost containment and monitoring

8. The Commission has proposed a 2% adjustment for achievable efficiencies with respect to reducing and better managing costs for RRE (and 1% for IST). This is to provide an incentive to manage, contain and reduce costs. Powerco notes Transpower's comments that its processes are more effectively targeting "whole of life" cost outcomes, meaning if processes are followed costs will be kept to a minimum in the long run. Again, Powerco is unsure what the evidence base is for the amount of the reduction.
9. Thank you for considering the points raised in this submission.

Yours sincerely



Paul Goodeve
Regulatory and Business Manager

¹ Commerce Commission, Regulation of Electricity Lines Services, Invitation for Submissions on 2010/11 Non-Part F Capital Expenditure Threshold for Transpower, May 2010, para 21.