



**Submission on revised draft determination  
- input methodologies & individual price  
path updates for Part 4 regulation of  
Transpower**

From

**Contact Energy Limited**

## Introduction

This submission by Contact Energy Limited (“Contact”) responds to the Commerce Commission’s (the “Commission”) development of regulations that will apply to Transpower under Part 4 of the Commerce Act (the “Act”).

Specifically, this submission addresses the revised draft decision and consultation updates, as identified in the following documents:

- Commerce Commission, “Individual Price-Quality Path (Transpower) Consultation Update Paper”, 9 November 2010 (“the IPP Update Paper”);
- Commerce Commission, “Input Methodologies (Transpower) Consultation Update” Paper, 12 November 2010 (“the IM Update Paper”); and
- Commerce Commission, “Revised Draft Commerce Act (Transpower Input Methodologies) Determination 2010”, 12 November 2010 (“the Revised Draft Determination”).

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## Material concerns around robustness of EV account and pass-through of risk not addressed

In Contact's submission<sup>1</sup> and subsequent cross-submission<sup>2</sup> to the Commission, we noted that Transpower is best placed to manage the risks associated with transmission system development and should be incentivised appropriately for doing so. The Commission has previously supported this observation<sup>3</sup>.

Contact's submissions also note that the regulatory framework that supports Transpower's decision making in this regard is required to produce outcomes that are consistent with those in competitive markets.

Contact is therefore surprised and disappointed that the material concerns raised by Contact and other customers of Transpower, particularly as they relate the HVDC and Economic Value Account ("EV account") components of Transpower's revenue requirement, have been ignored by the Commission.

The issues we have raised are material and, with a closing debit balance for the EV HVDC account in 2009 of NZ\$102.8m<sup>4</sup>, Contact expects issues relating to the carry-over of this balance and the mechanism for its recovery to be robustly debated as part of this consultation process.

Even though the Commission refers to a desire to foster "an informed and transparent process"<sup>5</sup>, the Commission appeared disinterested in meeting with Contact to discuss our concerns and has not raised any questions (even when prompted to do so by Contact) about the content of Contact's submissions.

In this submission, we therefore reiterate our original submissions and comment specifically on what we see as shortcomings in the conclusions reached in the IM Update Paper, the IPP Update Paper and the Revised Draft Determination. Contact believes these issues need to

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<sup>1</sup> <http://www.comcom.govt.nz/assets/Pan-Industry/Input-Methodologies/Draft-Reasons-Papers/Draft-Reasons-Transpower/Transpower-Draft-Decisions-Subs/Contact-Submission-on-Transpower-Input-Methodology-Draft-Determination-9-August-2010.PDF>

<sup>2</sup> <http://www.comcom.govt.nz/assets/Pan-Industry/Input-Methodologies/Draft-Reasons-Papers/Draft-Reasons-Transpower/Transpower-IPP-Cross-Submissions/Contact-Cross-Submission-on-Individual-Price-Quality-and-Draft-Reasons-Paper-for-Transpower-Input-Methodologies-25-August-2010.pdf>

<sup>3</sup> [http://www.comcom.govt.nz/assets/Imported-from-old-site/industryregulation/Electricity/ElectricityLinesBusinesses/TargetedControl/ContentFiles/Documents/Final-Decision-Paper---Transpower\\_s-Instantaneous-Reserves.pdf](http://www.comcom.govt.nz/assets/Imported-from-old-site/industryregulation/Electricity/ElectricityLinesBusinesses/TargetedControl/ContentFiles/Documents/Final-Decision-Paper---Transpower_s-Instantaneous-Reserves.pdf) para 115.

<sup>4</sup> Now \$109m, which is net of Transpower's tax, hence the customer charge balance is ~\$153m.

<sup>5</sup> IPP Update Paper, p.2.

be raised and appropriately dealt with in order to best meet the purpose of Part 4, the central and primary objective of which is to promote the long-term benefit of consumers.

## Comments on the IPP Update Paper

The IPP Update Paper notes that comments are sought on how the Draft Determination gives effect to the draft decisions, subject to the updates in the paper and drafting refinements. Contact's comments focus on the impact of the updates provided in the paper.

### Wash-ups & economic value framework

The Commission notes in the IPP Update Paper that it considers that<sup>6</sup> *“Transpower's existing method for calculating the annual wash-ups of the actual revenue against the MAR and for determining the adjustments to the EV accounts using its annual EV Statements has worked satisfactorily in the past and is acceptable going forward.”*

Contact is disappointed that the material issues it has raised in its submissions, regarding both the method for calculating the annual wash-ups and the balances that drive the wash-ups, have been ignored in reaching this conclusion. The Commission's IPP Update Paper does not even acknowledge the existence of our concerns in the “Submitter's views” tab of the “Wash-ups” section of the paper.

Contact has requested but has still not seen any evidence from the Commission to support its conclusion that the existing EV account balances represent an appropriate starting point for the EV account recovery process proposed. Contact considers that the Commission's analysis and supporting evidence used in reaching this conclusion should be made available for review.

The Commission is also required to ensure that outcomes are consistent with those of competitive markets, yet the Commission has done nothing to address concerns that the EV account balances are not consistent with such outcomes. In its submissions, Contact identified such concerns as including:

- The level of disclosure of HVDC and HVAC account balances being insufficient to allow Transpower's customers to properly understand movements in the EV account balances;

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<sup>6</sup> IPP Update Paper, p.6.

- Publishing only net balances masking the underlying (diverging) trends in the EV HVDC and EV HVAC accounts;
- During the period prior to the administrative settlement (and therefore before there was any disclosure of the individual EV account balances), Transpower bearing no cost risk and lacking any incentives to manage its costs;
- Between 2007 and 2009, the EV HVDC account balance increasing from an opening debit balance of NZ\$62.4m to a closing debit balance of NZ\$102.8m, driven primarily by the substantial increase in instantaneous reserve (“IR”) costs that was initially borne by Transpower as a direct result of its decision to decommission Pole 1 of the HVDC link;
- Transpower’s treatment of IR costs having the same effect as if the costs were treated as pass-through costs, even though the Commission supports the view that IR costs must not be treated as pass through costs and notes the undesirable incentives and signals that would be provided should they be passed through; and
- IR costs being allocated in a way whereby HVDC customers are subsidising HVAC customers.

As Contact has already submitted, the Commission must ensure that only those components of the existing balances that can clearly be identified as consistent with outcomes that would apply in a workably competitive market and promote the long-term benefit of consumers are carried forward. The Commission has not provided any indication that this is the approach that will be adopted even though the materiality of this issue to HVDC customers necessitates proper consideration of it – even when only accounting for appropriate treatment of OPEX costs, the appropriate closing EV HVDC balance for 2009 is NZ\$68m, or ~NZ\$35m less (lower debit) than the closing balance identified by Transpower, and assumed by the Commission to be applicable.

As it stands, the Commission’s response allows incorrect signals to continue to be sent to Transpower’s customers and could cause them to act in a manner which is inefficient and detrimental for consumers. This cannot be *“in the long term best interests of consumers”*.

## **MAR updates**

Aside from the appropriateness of the EV account balances, the effect of the recovery of the EV account balances over a period of 9 years, combined with the proposed annual update of EV adjustments (to clear the EV account balances that accrue from a previous year at the first available MAR update) will be that Transpower customers are likely to face significant, and volatile, changes in annual charges.

Contact previously submitted that if issues around the classification of IR costs and OPEX were remedied, then there may be some value in adjusting MAR within regulatory periods. These issues have not, however, been addressed and the draft decision could easily result in outcomes which are inconsistent with the specific purpose provision for input methodologies which is to *“promote certainty for suppliers and consumers in relation to the rules, requirements, and processes applying to the regulation, or proposed regulation, of goods or services under this Part”*.

## **Compliance framework**

As with the concerns raised by Contact regarding the EV account balances and their recovery, our concerns relating to compliance in the form of disclosure of EV account balances are not even noted in the IPP Update Paper as “Submitter’s views”.

Separate accounts for HVDC and HVAC OPEX (with their own individual CPI caps) must be created and maintained, with disclosure of cost allocation methodologies to those accounts being to a standard required by electricity distribution businesses. This level of information would be required in a competitive market for transmission services, and is the only way an appropriate allocation of costs within the EV accounts can be assured.

## **Instantaneous reserves**

In relation to event charges, the Commission concludes that an allowance for event charges should continue to be included in operating expenditure on the basis that a number of outages will occur for which Transpower should not be penalised. The Commission’s position seems to be that the inclusion of the allowances as operating expenditure (subject to a cap) would provide incentives on Transpower to minimise the number of events it causes. Contact and Meridian, as noted by the Commission, oppose this approach on the basis Transpower is best placed to manage event risk, rather than its customers.

The Commission’s reliance on an OPEX cap as a mechanism for providing the incentives to Transpower is unjustified, given that similar charges over which Transpower has control (e.g. Pole 1 related instantaneous reserve charges that drove the current EV account balances) are effectively passed through via cross subsidisation in the OPEX accounts. For this reason, customers of Transpower can have no assurance that they will not simply face the cost of all events, despite the proposed \$800,000 cap.

The Commission notes that Transpower believes it will face an increasing exposure to event charges as it will be determined to be the causer of more events. Given this, why should customers face **any** costs associated with events that are caused by Transpower and what real incentive does it provide Transpower with to manage these risks? In a workably competitive market the ability of a service provider (determined to be the causer of the event) to pass on any such costs to its customers would be minimal.

## **Comments on the IM Update Paper**

### **Capping Transpower's liability in the event of outages longer than 14 days**

The Commission states that its draft decision is consistent with outcomes expected of a workably competitive market, with Transpower being exposed to some financial risk relating to instantaneous reserve costs associated with extended outages where costs are not capitalised. Contact is pleased to note that charges allocated to Transpower that are attributable to HVDC Pole 3 commissioning and HVDC Pole 2 control systems integration will be required to be capitalised

The Commission proposes that 50% of the instantaneous reserve charges be recoverable, subject to a 1% of annual revenue per event cap, for each day of an outage beyond 14 days. Prior to this period, all charges (not capitalised to the project) will be recoverable. Contact does not consider this approach is an appropriate one for the reasons set out below.

The Commission states that this concept of 'sharing' of costs is based on a principle relating to capability to influence reserve costs. If this is the case, it is not clear why there should be a 14 day threshold at all (presumably the principle of influence doesn't simply commence on day 15). Contact believes that while customers may be able to influence the cost of mitigating the impacts of an outage, the primary causer (or influencer) of the outage will be Transpower not its customers and therefore it should accept the responsibility for adverse (outage) outcomes.

Contact submits that any judgemental threshold (under which costs are recoverable), 'sharing' arrangement or value cap significantly reduces Transpower's already limited incentive to limit outages, given the existing issues around effective pass-through of costs determined as being recoverable. It is unrealistic to assume a similar service provider in a workably competitive market would be able pass on so much risk to its customers via so many different avenues and subject to so many limitations on liability.

## Alternative wording

While Contact is happy to provide alternative wording (as requested), given the fundamental concerns we have in some key areas relating to the determination we would prefer to discuss these concerns with the Commission first.