



10 March 2006

Transpower Post-Breach Inquiry  
Network Performance Group  
Networks Branch  
Commerce Commission  
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To whom it may concern,

## **Cross-submission in relation to the Commerce Commission's Intention to declare price control on Transpower New Zealand Ltd**

1. Mighty River Power welcomes the opportunity to make a cross-submission in relation to the Commerce Commission's (CC's) Draft Report "*Regulation of Electricity Lines Businesses – Targeted Control Regime – Intention to Declare Control – Transpower New Zealand Ltd*" ("*the Transpower Price Control Inquiry Paper*"), 31 January 2005.
2. No part of our submission is confidential and we are happy for it to be publicly released.

### ***Mighty river power's comments on the other submissions***

3. Mighty River Power has reviewed the submissions made by other parties in full. As a result, we have comments to make in relation to:
  - a. Use of pricing thresholds v the building block approach;
  - b. Affect of price control on future investment (as assessed in the CC's quantitative cost benefit analysis (CBA));
  - c. Use of a factual/counterfactual in the CBA; and
  - d. Implications of Transpower's announced price increases for end-users.

### ***Pricing thresholds v building block***

4. The submissions that commented on the CC's use of the price thresholds as a substitute for a building block analysis were consistent with our submission.<sup>1</sup> In particular, they were consistent with our view that: (i) the price thresholds are only suitable as an initial screening tool; (ii) a building block analysis is needed to determine whether a breach of the price threshold was justified or not; and (iii) a building block analysis is needed to identify the level (if at all) of excessive profits.

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<sup>1</sup> Powerco, Transpower (including various consultants such as Castalia, Charles River Associates and NERA), and Vector.

5. We agree with Powerco's comment that *"There is no substantiation by the Commission of its inference that Transpower's investment programme is more complex or less certain than that of any other lines business. On the contrary, it might reasonably be argued that the EGR framework provides a higher degree of transparency in relation to Transpower's investment programme. The information available to the Commission through the Grid Upgrade Plans and other documents may readily facilitate the establishment of alternative future investment and price paths (i.e. factual scenarios)."*<sup>2</sup>
6. NERA also make a valid point that the price threshold (and therefore whether there was a breach/the size of the breach) is very much a function of *"The arbitrariness of the Commission's threshold starting point"*.<sup>3</sup> We stress that this does not mean that the price threshold is inappropriate; it just means that its usefulness is limited to providing a screening mechanism to assist the CC to identify whether to investigate Electricity Lines Businesses (ELBs)/apply pressure on ELBs to moderate their prices overtime consistent with Section 57E of the Commerce Act.<sup>4</sup>
7. We agree with Transpower and Powerco that the information that Transpower provided to the CC under section 98 of the Commerce Act could have been used as the basis for a building block analysis.
8. We also agree with Charles River Associates (CRA) that the CC could use different scenarios to reflect the impact of different approved levels of capital expenditure.<sup>5</sup>

#### ***Affect of price control on future investment***

9. The submissions that commented on the affect of price control on Transpower's future investments were consistent with our questioning of the extent to which price control would improve the efficiency of Transpower's future investments.<sup>6</sup> In particular, the submissions were consistent with our view on the urgency of substantial future grid investment, and that delays in this investment could actually result in dis-benefits rather than the benefits that the CC claim.
10. We also agree with CRA's analysis of how transmission constraints (exacerbated by delays in transmission investment) can have a negative impact on competition in the wholesale electricity market.<sup>7</sup>

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<sup>2</sup> Page 7 of Powerco's submission.

<sup>3</sup> Page 13 of NERA's submission.

<sup>4</sup> As reinforced by the High Court decision of Unison Networks Limited v Commerce Commission (Wild J 28 November 2005, Wellington, Registry CIV 2004 485 960).

<sup>5</sup> Page 6 of Charles River Associates' submission.

<sup>6</sup> Powerco, Transpower (including various consultants such as Charles River Associates) and Vector.

<sup>7</sup> Subsection 4.2 of Charles River Associates' submission.

### *Use of a factual/counterfactual in CBA*

11. We agree with CRA's view that "*The Commission has not specified a factual against which a counterfactual can be compared. Without this, it is not possible to carry out a rigorous cost benefit analysis of control of Transpower. In particular, the form of regulation under the factual matters, as it affects incentives and therefore efficiency*".<sup>8</sup>

### *Implications for end-users*

12. We share the Electricity Networks Associations' concern about how Transpower's customers should deal with Transpower's announced 1 April 19% price increase, given that the CC's decision on price control could result in the price increase being reversed or, if the CC is able to meet its currently targeted deadline, not going ahead.
13. Given the notice period etc required for price increases, distribution ELBs have announced their price rises to factor in Transpower's price increases, and electricity retailers have done the same. If the transmission price increase does not go ahead (because of price control), the distribution ELBs would not be able to re-issue their new rates in time to avoid the increases filtering through into retail tariffs. This creates an unsatisfactory situation for our customers, and end-users generally. At best they will face price increases that prove to be unneeded, and end up being reversed. Such a situation is likely to cause customer dissatisfaction
14. It is difficult to see what the CC could do about this – given the existing legislation – beyond what the CC is already doing (such as attempting to make a decision on its intention to price control Transpower before 1 April). The timing of the announced price increase is very unfortunate. However, given the Government intends (based on CC recommendation) to amend Part 4A such that it will apply to Gas Pipeline Businesses (GPBs), this amendment could be used as an opportunity to give the CC the power to veto price increases by ELBs/GPBs that are under investigation for threshold breaches. Regardless, given the impact on end-users, this is an issue that we consider is worth emphasising, and that the CC should bear in mind.

### *Concluding remarks*

15. Mighty River Power appreciates the priority that the CC is given to the investigation into whether to apply price control on Transpower, and the CC's endeavour to make a final decision on this matter prior to Transpower's announced 19% price rise taking effect on 1 April 2006. We are aware that our recommendations that the CC apply a building block approach to its CBA, and that the CC hold public hearings, would mean that the CC would not be able to make this deadline. This could create an unsatisfactory situation of temporary price rises which then had to be reversed; but this is liable to happen anyway given the time lags between price increase announcements and when the price increases

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<sup>8</sup> Page 1 of Charles River Associates' submission.

take affect. ELBs and retailers will have adjusted their prices on the basis of Transpower's announcements, to coincide with the announced timing of the price increase.

16. If you have any queries regarding this submission or Mighty River Power's views please do not hesitate to contact me ([neil.williams@mightyriver.co.nz](mailto:neil.williams@mightyriver.co.nz)) or Rob Allen (09 308 8259 or [robert.allen@mightyriver.co.nz](mailto:robert.allen@mightyriver.co.nz)).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Neil Williams', with a long horizontal flourish extending to the right.

Neil Williams  
General Manager - External Affairs