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6 August 2010

Karen Murray  
Commerce Commission  
PO Box 2351  
WELLINGTON

By email: [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz)

Dear Karen

## Input Methodology and Individual Price-Quality Path for Transpower

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Genesis Power Limited, trading as Genesis Energy, welcomes the opportunity to provide a submission to the Commerce Commission ("Commission") on the consultation papers "Input Methodologies Transpower: Draft Reasons Paper" and "Individual Price-Quality Path Transpower: Draft Reasons Paper" dated June 2010.

Genesis Energy has not attempted to respond to all of the matters dealt with in the Commission's consultation package, but has focussed on issues most relevant to our business. As a general comment, Genesis Energy notes that the Commission's consultation process is difficult for parties other than the regulated businesses and their advisors to participate in and suggests that the consultation papers could be written to be more accessible to a broader range of interested parties.

### **Minor and Major Capex Threshold**

Genesis Energy considers that the proposed \$5 million threshold for distinguishing between minor and major capital expenditure (capex) is far too low and risks producing perverse outcomes.

Genesis Energy notes that Transpower currently has 55 small projects underway with an average project value of \$5.6 million.<sup>1</sup> This indicates that a large number of projects will fall in the minor capex basket and that \$5 million is not a large sum in transmission investment terms. Genesis Energy is concerned that a low threshold will be overly restrictive and will, for example, encourage Transpower to favour low-cost like-for-like replacement projects in situations where upgrades would be preferable.

Genesis Energy suggests that the Commission should set the threshold at least to \$20 million which is at the lower bound suggested by Transpower.<sup>2</sup>

### **Recoverable versus Pass-through Costs**

Genesis Energy is generally satisfied with the approach the Commission has taken with defining and distinguishing between recoverable and pass-through costs. However, we recommend that the Commission consider incorporating a degree of industry consultation into the third step of the criteria for pass-through costs and amending the clause as follows:

“approved as a Pass-Through Cost by the Commission, following industry consultation.”<sup>3</sup>

The rationale for this is that it is not always straight-forward to understand the drivers of particular costs and the degree of control that Transpower has over those costs. For example, reserves costs are a function of market design, generator offer prices and volumes and the availability of key grid assets. A consultation process would assist the Commission to understand the drivers for particular costs and the merits of incentivising Transpower to manage those costs.

### **Treatment of EV Accounts**

Genesis Energy supports the approach of Transpower disclosing HVAC and HVDC costs separately and the methodology for doing so (section 3.6.5 of Transpower’s individual price-quality path). Genesis Energy agrees with the Commission’s assessment that this approach would provide an optimal balance

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<sup>1</sup> Transpower (2009), *08/09 Annual Report*, Transpower New Zealand Ltd, p.6

<sup>2</sup> Commerce Commission, *Electricity Transmission Workshop Transcript*, 3 March 2010, p. 98, lines 22-28.

<sup>3</sup>Section 7.4.2, Input Methodologies Transpower Draft Reasons Paper, June 2010, Commerce Commission.

between information disclosure and Transpower's ability to reallocate operational expenditure during a regulatory control period.

Genesis Energy supports the Commission's decision to require Transpower to disclose its costs, adjustments and charges separately to HVAC and HVDC customers, as part of its annual compliance statement under the individual price-quality path determination. In addition to this, we believe that is essential that there is a clear framework for what items may be included in the Economic Value (EV) accounts and how the accounts are to be calculated. Genesis Energy recommends that the Commission prepare separate material on this for consultation with affected parties.

Genesis Energy agrees with the Commission's proposal to settle the current EV account balances for HVAC and HVDC to zero by the end of the first and second regulatory control period respectively. The paper specifically notes the asset transfer between Genesis Energy and Meridian,<sup>4</sup> and raises a question of whether the Commission should be concerned about allocation of liability for EV account adjustments. Genesis Energy considers that, in the case where a party acquires existing South Island generation assets, allocation of liability for historic EV account costs is a commercial matter that can be negotiated between the parties and should not influence the Commission's decisions regarding the HVDC EV account. However, Genesis Energy suggests that the Commission should consider the case of a party constructing new generation assets in the South Island. In this case, it would be desirable to ensure that such a party is not exposed to liability for historic EV account costs.

Genesis Energy supports the approach of ensuring both the HVAC and HVDC EV account balances are settled to zero at the end of each subsequent regulatory control period. This will avoid the current situation of large outstanding balances accumulating over time. However, we note that settling an EV account to zero every five years may lead to large payments if large changes to an EV account occur late in a regulatory control period. Genesis Energy suggests that the Commission should maintain the discretion to allow rebalancing to occur over a number of years where this will avoid severe rate shocks.

### **Treatment of Reserve Energy Costs**

Genesis Energy notes that Transpower's decisions regarding the availability of HVDC poles can have a significant influence on reserves costs, and that this is particularly critical in the period leading up to commissioning of HVDC Pole 3.

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<sup>4</sup> Section 3.9.17, Individual Price-Quality Path Transpower, Draft Reasons Paper, June 2010, Commerce Commission.

Another key driver for reserves costs is the price and quantity of reserve offered by generators. As such, reserves costs can be influenced both by Transpower and by Transpower's HVDC customers.

The Electricity Governance Rules (and the Electricity Industry Participation Code in future) require Transpower to make its grid assets available to the market if they are not on an outage. As such, Genesis Energy considers that the main value to exposing Transpower to reserves costs would be to incentivise Transpower to maintain the HVDC link in a state that limits forced outages.

Accordingly, Genesis Energy suggests that Transpower should be able to recover all reserves costs other than those occurring during a forced outage of an HVDC pole.

### **Quality Measures**

Genesis Energy supports the introduction of a performance incentive regime and the five quality measures identified for inclusion in the individual price-quality path. We believe this will provide an appropriate incentive for Transpower to align the quality of transmission services with customer preferences.

While Genesis Energy supports the two availability measures proposed, we suggest that the Commission considers developing and testing a measure based on availability of transfer capacity. This is a key driver for constraints that cause out-of-merit generation dispatch and, as such, is a key metric for generators and for consumers of electricity transmission services.

Genesis Energy notes the Commission's reasoning for not setting targets, caps and collars for the HVDC bi-pole availability measure in the first regulatory control period and supports the decision to require disclosure of information on this measure until a sufficient data history is gathered.

Genesis Energy understands the rationale for not introducing revenue at risk and reward at the commencement of the new regulatory regime, but queries whether the Commission is being too cautious. The Commission could place a small proportion of income at risk or reward for the latter years of the first regulatory period (for example, years three and four). This would bring forward the anticipated benefits to consumers of the performance incentive regime.

### **Incremental Rolling Incentive Scheme**

Genesis Energy supports the introduction of an incremental rolling incentive scheme for Transpower. We believe this will provide a stable and consistent incentive for Transpower to seek efficiency improvements. Genesis Energy is

comfortable with the decision not to apply the scheme in the transition year of the first regulatory period.

#### Exclusion of Net Efficiency Losses

Genesis Energy questions why the incentive scheme focuses solely on efficiency gains and unlike the Australian Energy Regulator's Efficiency Benefits Sharing Scheme (EBSS), does not allow net efficiency losses to be carried over to reduce Transpower's future operational expenditure allowance. The Australian regulator decided to incorporate net efficiency losses as it believed that it would "ensure that incentives are constant and symmetric". The 2007 Australian EBSS report also noted that:

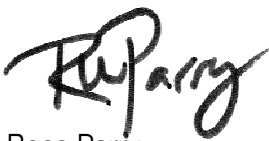
".....the observed experience of the [Essential Services Commission of Victoria] was that the asymmetrical application of the carryover mechanism in an earlier version of a similar scheme in Victoria had led to the scheme failing to meet its objectives".<sup>5</sup>

We believe the proposed approach will not incentivise Transpower to address ongoing efficiency losses and as noted by the Commission, it will slightly skew the sharing ratio of benefits more in favour of the Transpower (over consumers).

Genesis Energy appreciates that this is the first time such a mechanism has been implemented. At a minimum, we recommend that the Commission review the incentive mechanism at the end of the first regulatory period and determine if it should be revised to incorporate net efficiency losses.

If you would like to discuss any of these matters further, please contact me on 04 495 3348.

Yours sincerely



Ross Parry  
Regulatory Affairs Manager

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<sup>5</sup> Final decision: Electricity transmission network service providers – Efficiency benefits sharing scheme, September 2007, Australian Energy Regulator <http://www.aer.gov.au/content/item.phtml?itemld=715254&nodeld=8d2ae524d671386612a288af8676d696&fn=Final%20decision%20-%20efficiency%20benefit%20sharing%20scheme.pdf>