



TRANSPOWER

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Alex Sim
Regulation Branch
Commerce Commission
PO Box 2351
WELLINGTON

Dear Alex

Re: Recommendation to the Minister regarding the type of regulation to apply to Transpower

Thank you for the opportunity to comment on the Commerce Commission's consultation document *Recommendation to the Minister regarding the type of regulation to apply to Transpower*.

Transpower agrees with the Commission's overall finding that individual price-quality regulation is the most appropriate form of regulation for Transpower and generally agrees with the Commission's analysis supporting that conclusion. However, we have identified a few points of concern with respect to the paper and the content of Appendix A, which we discuss below.

Quality standards

The consultation paper describes the Commission's general approach to the setting of quality standards for Transpower, which we believe is appropriate in concept. However, we draw to your attention the fact that the Commission's intentions may be constrained by clause 149 of the Electricity Industry Bill which, if passed, will create a new section 54V(4) of the Commerce Act 1986, viz.:

"54V(4) The Commerce Commission may include in a section 52P determination relating to price-quality regulation for Transpower only the quality standards set by the Authority for Transpower."

This provision would replace the existing section 54M(6) of the Act, which states:

"54M(6) The only requirements that may be included in a section 52P determination in respect of the quality standards of Transpower are requirements that give effect to the quality standards set by the Electricity Commission."

Footnote 14 of the consultation paper notes that section 54M(6) may be repealed, but does not refer to its proposed replacement by section 54V(4)). Transpower believes that the proposed change envisaged by the Bill is inappropriate because it would remove all discretion from the Commerce Commission to determine the quality

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measures that it believes would be most suitable as part of Transpower's price-quality regulation. Instead, the measures that must be used would be determined, and potentially amended, by another Crown entity for a separate purpose. The situation would also be unusual insofar as the availability and reliability service measures set by the Electricity Industry Participation Code ("Code") for interconnection assets, and the equivalent measures that form part of the Benchmark Agreement ("BA") for connection assets, would not be enforceable pursuant to the Code or the BA, but would effectively be enforceable as part of price-quality regulation under Part 4 of the Commerce Act 1986.

Transpower will be submitting to the Finance and Expenditure Select Committee recommending that the wording of the proposed section 54V(4) be amended to use the wording "take into account" or, alternatively, that 54V(4) simply be deleted, given that the proposed section 54V(2)(a) already uses the phrase "take into account" as follows (reflecting the current section 54V(2)(a) and (b)):

"54V(2) The Commerce Commission must take into account, before exercising any of its powers or performing any of its duties or functions under this Part,—

- (a) any provision of the Code, or decision made under it, that relates to or affects the quality standards or pricing methodologies or performance requirements applicable to Transpower:..."

Timetable

The timetable set out in Table 1 on page 25 of the consultation document presents some practical difficulties with respect to the calculation of transmission prices for the 2012/13 pricing year. In order for transmission prices to be calculated, audited and notified to customers by the end of 2011, the revenue requirement used as the basis for the calculations must be finalised by the end of Q3 2011 at the latest. This means that the Commission's final decision on expenditure would need to be made by the end of Q3 2011. We anticipate that further discussions with Commission staff should enable this problem to be resolved.

Appendix A

Appendix A to the consultation document summarises material provisions of the type of regulation that is likely to apply if the Commission were to implement individual price-quality regulation for Transpower. While we appreciate that the Commission's intention is to provide this summary as an illustration for the Minister's information, we are concerned that it is presented almost as a *fait accompli* before any consultation has been undertaken on the detail of the input methodologies.

We have particular concerns about the following paragraphs in the Appendix:

A8-10 Quality standards

The Commission's intentions with respect to quality standards may not be able to be implemented if clause 149 of the Electricity Industry Bill is passed and incorporates the proposed new section 54V(4) into the Act (see comments above).

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A 20 System Operator activities to be regulated services under the Act

This proposal would create additional compliance costs for no additional benefit to consumers. The system operator's revenue and services are already governed by the terms of the system operator service provider agreement. Quality standards and performance obligations are governed by the Electricity Governance Rules, which will translate to the Electricity Industry Participation Code if the Electricity Industry Bill is passed. Adding a further layer of regulation would add costs but it is not clear what the benefits would be.

A major negative aspect of the proposal is that subjecting the system operator to the information disclosure requirements under the Act (albeit that the Commission proposes to set new requirements) could make it more difficult for the system operator to obtain commercially sensitive information from electricity industry participants to assist it to undertake the system operator function. This is because the industry participants may fear that the system operator could be forced to disclose this information pursuant to the information disclosure requirements.

A25 Cost of capital – industry-wide leverage assumption (3rd bullet point)

We believe that, because of the unique characteristics of Transpower's business, it would be more appropriate to use Transpower's actual leverage rather than an industry-wide leverage assumption.

A32 Pass through costs

We believe that there is a strong case for allowing instantaneous reserves availability costs to be treated as pass through costs under individual price quality regulation. These costs are driven by generator offer behaviour which is entirely outside Transpower's control and also impossible to predict in anything other than the short term, because changing weather conditions can have a critical effect on offer behaviour and power flows in a hydro dominant power system. Hence, the reserves availability costs are largely uncontrollable by Transpower other than by modifying transfer capacity on the HVDC link, which would be contrary to the interests of consumers and likely to be inconsistent with the capacity service measures contained in the Electricity Governance Rules, unless permitted by the outage protocol.

When Transpower raised the possibility of an extension to the class of pass through costs in 2008 the Commission's decision to decline to add instantaneous reserves availability costs to this class largely hinged on the terms of Transpower's administrative settlement agreement with the Commission. The expiry of this agreement on 30 June 2011 presents an opportunity to reconsider the merits of a possible extension.

Yours sincerely



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