



TRANSPOWER

Transpower House, 96 The Terrace,
PO Box 1021, Wellington,
New Zealand
Telephone +64-4-495 7000
Facsimile: +64-4-495 7100
www.transpower.co.nz

Richard Fletcher
richard.fletcher@transpower.co.nz

22 November 2010

Submissions
Electricity Authority
PO Box 10041
Wellington 6143

Dear Sir/Madam

Re: Interpretation of the Electricity Authority's statutory objective, Charter about advisory groups and Consultation Charter

This is Transpower New Zealand Limited's submission on the following Electricity Authority (Authority) consultation papers:

- *Interpretation of the Electricity Authority's statutory objective*, 8 November 2010
- *Charter about advisory groups*, 8 November 2010
- *Consultation Charter*, 8 November 2010.

Transpower supports the foundation documents in general, but believes further clarification would be valuable in a number of areas. Overall, the documents provide a framework which should enable productive dialogue and constructive relationships within the Electricity Supply Industry.

Interpretation of the Electricity Authority's statutory objective

Transpower generally concurs with the Authority's interpretation of the statutory objective and particularly with the need for the interpretation to be clear and straightforward. However, we believe that experience with the previous regulatory regimes identifies two areas where further clarification of the statutory objective will pay dividends by better defining the scope and focus of the Authority. These areas are:

- With respect to transmission, co-ordination of powers and functions with the Commerce Commission. This would address a problem that arose during the tenure of the former Electricity Commission. The Electricity Commission proposed, as part of the Transmission Pricing Review, the possible development of an unconditional service guarantee that would involve financial penalties, at the same time as the Commerce Commission was developing a quality performance regime that would place some of Transpower's revenue at risk. This sort of double jeopardy situation is undesirable and wasteful of corporate and governance resource. Consequently, we suggest that the

22 November 2010

Authority's interpretation of its statutory objective take account of desirability of consistency across regulatory regimes.

- With respect to system operation, the need to emphasise the importance of real-time security within the framework of an efficient market. The Authority interprets the "promoting reliable supply" objective as:

"Exercising all of its powers and functions in ways that encourage market participants to develop and operate the electricity system to manage security and reliability in ways that minimise total costs whilst being robust to adverse events."

As a reasonable and prudent system operator, Transpower believes that the statement should clearly emphasise real time security, which must be robust to continuous contingency events and to high impact low probability events. The interpretation should be amended to read:

"Exercising all of its powers and functions in ways that encourage market participants to develop and operate the electricity system to manage security and reliability in ways that minimise total costs whilst being robust to ongoing contingencies as well as adverse high impact low probability events."

Charter about advisory groups

We agree with the Authority's choice of option 2 for allocating the decision-making responsibilities of the advisory groups. It is Transpower's view that this approach is the option most likely to encourage the highest level engagement by the industry.

We also believe that this engagement will be enhanced if the Advisory Group charter is amended to specifically state that the Authority Board will take account of the recommendations of advisory groups.

As noted in the consultation papers, the proposed role of the Security and Reliability Council (SRC) has a slightly different emphasis from that which was first tabled. The requirements of the Act specify the roles that the SRC must fulfil, but we believe that extended roles as envisaged in the Review and by Cabinet would add value to the overall regulatory framework. In particular, we believe the SRC would provide the most valuable advice if it were encouraged to have direct and open dialogue with the System Operator. By doing so it would:

- be able to understand, consider and then advise the Authority on key system operational matters;
- be a good 'sounding board' for the System Operator on technical security of supply matters (fully accepting the Authority as the System Operator's counterparty);
- encourage the nomination of senior people for appointment to the Council.

We agree that the SRC should not be involved in detailed Code change proposals, but it should have the mandate to advise on developments that may require Code changes to be advanced through the advisory groups.

22 November 2010

We look forward to working closely with the SRC and using our operational and technical expertise as System Operator to support and assist the SRC with its work.

The Authority has asked for comment on whether it or the System Operator should be the spokesperson with regard to security, especially during conservation programmes. Through the process of fulfilling its emergency management role Transpower, as System Operator, will receive, hold and analyse the key information required to fulfil the communications role. While the System Operator will be keeping the Authority briefed during emergencies, it is anticipated that the communication role will be largely operational in nature. Having the Authority as the spokesperson would be likely to introduce delays while full briefing of the Authority staff and Board were carried out which might affect critical timelines. For these reasons we believe that the System Operator is the appropriate spokesperson on these matters.

We support the proposed advisory group structure and look forward to taking an active role in the Wholesale and Transport Advisory groups (WAG and TAG) and their working groups.

We believe that, excepting any confidential material, it should be a requirement that all SRC, advisory group and working group papers, agendas, minutes and recommendations should be made publically available with a minimum of delay.

Consultation Charter

Clearly set out evaluation criteria for quantitative cost benefit analysis provides both rigour and fairness. However, we have concerns about a number of the proposed Code amendment principles and believe that some aspects of them would benefit from clarification:

Principle 2 – Clearly Identified Efficiency Gain or Market or Regulatory Failure

The first bullet under the accompanying explanation to this principle could benefit from being expanded to include the words underlined:

- It can be demonstrated that enhancements to the Code will improve market efficiency, including by reducing compliance or transaction costs or by reducing the scope for disputes between industry participants;

In some cases, improvements to the Code that reduce compliance or transaction costs by improving procedures, or reduce the scope for disputes by making wording more precise, can save millions of dollars worth of time and effort, but it might not always be clear that such changes come within the ambit of improving market efficiency.

Principle 3 – Quantitative Assessment

While we agree that quantitative cost-benefit analysis should be used whenever possible, in some cases it will not be possible. This point comes through in the *Rationale for each principle* set out on page 8 of the Consultation Charter, but is

22 November 2010

missing from the principle itself. We suggest that Principle 3 include the words “the Authority recognises that quantitative analysis will not always be possible”.

We appreciate that Principles 4 to 8 are “tie breaker” principles, but we believe that, although applicable in a lot of market situations, there may be other instances where applying the principles will not be appropriate and may in fact be counter productive to overall efficiency.

Principle 4 – Preference for Small-Scale ‘Trial and Error’ Options

The key elements of an initiative that meets the requirements of this principle are that the option should be reversible and scalable and, in our view, have low value transfer characteristics. Small-scale changes could still result in changes to the Code that, when reversed, might impose compliance costs and costs associated with interpretation and consequent errors and disputes that might not always be apparent prior to the changes being made. A better principle would be “a preference for rule changes that are reversible and scalable and which have low value transfer characteristics”.

Principle 7 – Preference for Opt-Out Features

This principle should clarify that more restrictive options (i.e. that do not allow opt out) may be justified not just on the grounds of non-rivalry and/or non excludability, but because the nature of the Code provisions is such that sets of industry participants must be subject to them. Examples of where opt out provisions are not appropriate are:

- the transmission pricing methodology, which must apply to all transmission customers if Transpower's revenue is to be recovered, and similarly ancillary service cost allocation
- the technical requirements for assets, which must be complied with to ensure that health and safety standards are achieved
- the process for entering a transmission agreement, the objective of which would not be achieved if participants were permitted to opt out of the process.

We suggest that this principle, if adopted, have its application limited to amendments to the Code that do not relate to the “common good” characteristics of the industry.

Principle 8 – Preference for Non-Prescriptive Options

While we understand the intention of this provision, in some cases making the Code less prescriptive would increase the scope for costly disputes and also the scope for lobbying and rent seeking behaviour. We have observed these outcomes in the past when, for example, elements of the transmission pricing methodology were less prescriptive than they are today.

Another current example of the use of non prescriptive options would be the provisions relating to compliance with the power factor requirement in the Connection Code. In practice, the approach adopted, which leaves it to industry participants to find the best way to achieve compliance, has simply resulted in general non-

22 November 2010

compliance and no action. Consequently, we suggest that either this concept be applied as a guideline that the Authority may use from time to time when it is appropriate to do so or that its application be restricted to the "market" provisions of the Code only.

Process for considering Code amendment proposals

We note that clause 4.15(a) of the Consultation Charter paper does not provide any particular timeframe within which the Authority should determine whether or not a proposed Code amendment is a matter that may be included in the Code. We suggest that the Charter should provide some limitation with respect to time, even if it is simply "within a reasonable time".

In conclusion, any points we have made are intended for the purposes of clarifying the foundation documents. Overall, Transpower is pleased with and supports the general thrust of the Authority's proposals and looks forward to working collaboratively with the Authority and the industry under this framework.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R. Fletcher', with a small dot at the end.

Richard Fletcher
Regulatory Strategy Manager