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26 August 2011

Paul Melville  
Regulation Branch  
Commerce Commission  
PO Box 2351  
WELLINGTON

Dear Paul

## **Re: Capital Expenditure Input Methodology (Transpower) – Draft Decisions and Determination Drafting**

This is Transpower New Zealand Limited's cross-submission on:

- *Capital Expenditure Input Methodology (Transpower) – Draft Reasons Paper, and*
- *Draft Commerce Act (Transpower Input Methodologies) (Capital Expenditure) Determination 2011.*

We note that Genesis Energy Limited was the sole submitter (in addition to Transpower). Consequently, our comments in this cross submission are restricted to matters raised by Genesis in its main submission.

### **Competition Benefits – Investment Test**

We accept in principle the point raised by Genesis in its submission that competition benefits should correctly include any change in total economic surplus arising from electricity retailing and risk management activities, as well as from the wholesale market. We also agree with Genesis that wealth transfers should be excluded.

Our experience to date when considering competition benefits is that, with respect to the wholesale market, they are small relative to total benefits, and, in our view any competition benefits associated with electricity retailing and risk management would likely be even smaller.

In our experience, calculating competition benefits to any degree of certainty or accuracy is very difficult in practice and necessarily relies on a range of subjective assumptions. Such calculations require estimates of price elasticity of demand by consumers, projections of how generator bids would change in the face of increased or decreased competition, as well as assumptions about the future market development scenarios, including forecasts of the future ownership of new generation.

The work involved is difficult and problematic in relation to the wholesale market and it may prove impracticable in relation to the provision of hedge products. Hence,

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while we do not object to Genesis' proposed change to the definition of "competition benefits" we are not convinced it would result in any practical change to the way in which transmission projects are evaluated.

Genesis suggests that, given the difficulty of modelling the competition benefits of transmission investment, the Commission should consider defining a minimum standard of competition that transmission is expected to enable. We disagree with this proposal. Genesis has not proposed what it means by a minimum level of competition and it is difficult to see how such a concept could be satisfactorily applied in practice in conjunction with the grid reliability standards (GRS), given that the GRS require the Commission's Investment Test to be applied and the Investment Test provides for competition benefits to be assessed where these are significant and able to be quantified. Genesis' concept seems to envisage that there may be circumstances where the minimum level of competition is required to be maintained regardless of the cost of doing so. Following such an approach could result in welfare negative outcomes that would not be in the long term interests of consumers. In our view, assessing transmission investments against the GRS, using the Commission's Investment Test, which includes competition benefits where these are significant and quantifiable, is the approach most likely to be in the long term interests of consumers.

The issues noted by Genesis in relation to the possible use (or abuse) of market power would be better considered by the Commission as part of its general competition oversight function and/or the Electricity Authority in its role as arbiter of Undesirable Trading Situations.

### **Definition of Consumer**

When reviewing Genesis' proposed amendment to the definition of competition benefits, we noticed an apparent drafting problem with the definition of "consumer" in the draft Capex IM. The draft Capex IM makes reference to the definition of consumer in Section 52C of the Commerce Act, which indirectly refers to the definition of consumer in Section 2(1) of the Electricity Act. It is unclear whether the definition of consumer as proposed allows the application of the Investment Test to capture benefits to end-consumers of electricity as well as industry participants.

We recommend that the Commission review the definition of "consumer" that will apply to the Investment Test with a view to clarifying the definition. We would be happy to discuss this further with Commission staff.

Yours sincerely



Richard Fletcher  
Regulatory Strategy Manager  
Transpower New Zealand Ltd