# MAJOR ELECTRICITY USERS' GROUP

9 August 2010

Alex Sim
Regulation Branch
Commerce Commission

By email to regulation.branch@comcom.govt.nz

Dear Alex

**Submission on Transpower Individual Price-Quality Path Draft Reasons paper**

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission (the "Commission") paper titled "Individual Price-Quality Path Transpower, Draft Reasons Paper" dated 28th June 2010[1].

2. Comments on the draft decisions listed in the relevant chapter headings of the Draft Reasons Paper are set out in the appendix to this submission.

3. MEUG will be making a number of other submissions to the Commission on related draft decisions.

4. Nothing in this submission is confidential.

Yours sincerely

Ralph Matthes
Executive Director

[1] http://www.comcom.govt.nz/developing-new-price-quality-regulation-to-apply-to-transpower/

Appendix: Comments on Transpower IPP Draft Reasons paper

| Draft Reasons | MEUG comments |
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| **Chapter 3: Form of Control** | |
| First regulatory period to be 4 years and subsequent regulatory periods 5 years. | Agree. |
| Alignment of revenue from pricing years (year ended 31st March) with costs from financial years (year ending 30th June) as a matter of being pragmatic. | Agree. |
| Transpower to provide the Commission with its calculations of Maximum Allowable Revenue (MAR) at the start of September immediately preceding the next regulatory period starting 1st July the following year. The MAR must be calculated using the determinations set out in the final IPP and Input Methodologies. | Noted. MEUG assumes the calculation of MAR will be sufficiently transparent to allow any interested party to replicate the calculation by Transpower from publicly available information. |
| The Commission will in each case make a decision on MAR no later than 30th November. This will allow Transpower to reset and advise its customers of price changes effective 1st April the following year. | Noted. |
| A transitional provision to allow MAR to be recalculated for expenditure that falls between two regulatory periods and wash-ups is provided for. This is first applicable from the start of RCP2. | Noted. |
| Wash-ups will occur annually. | Noted. |
| The Settlement Agreement approach to calculating and reporting Economic Value (EV) accounts for HVAC and HVDC customers will continue. | Agree. |
| The $109 million (approximated) HVAC credit owed to customers to be returned to HVAC customers by the end of RCP1 (30th June 2015). | This is too long for the $109 million to be repaid. Consumers do not see any benefit in being a creditor to Transpower and are annoyed they are being forced to do so. Repayment within two years should be considered. |
| The $103 million HVDC EV debit payable by customers to Transpower to be recovered from HVDC customers by the end of RCP2 (30th June 2020). | This is too long for the $103 million owed to Transpower to remain outstanding. At a minimum the period this debt should be repaid should align with the above timing for Transpower to pay HVAC customers their $109 million credit. |
| In August each year Transpower must provide the Commission with an audited compliance statement for the most recent year ended 30th June. | Agree. MEUG agree with the Commission with the need for monitoring annual compliance, not just compliance at the end of each RCP, refer paragraph 3.10.12:<br><br>"Although Transpower's level of compliance with its approved level of Minor capital expenditure can only be assessed at the completion of the last year of each RCP, the Commission considers the disclosure of this and other information regarding Transpower's performance in each |

| Draft Reasons | MEUG comments |
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| | financial year is necessary. This disclosure serves various purposes, including, but not limited to;<br><br>a) creating a public record of actual performance, this being useful to interested parties;<br><br>b) informing the Commission of Transpower's quality performance and any associated adjustment to future revenue (by way of EV adjustment); and<br><br>c) Providing necessary information for the Commission to assess Transpower's compliance with its MAR, capital expenditure, the annual wash-up and associated EV adjustments." |

| Draft Reasons | | | | | MEUG comments |
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| **Chapter 4: Operating Expenditure** | | | | | |
| Definition of operating expenditure is consistent with the Settlement. | | | | | Agree. |
| Operating expenditure allowances are: | | | | | |
| • Set prior to commencement of the regulatory period. | | | | | Agree. |
| • Set for each year of the regulatory period. | | | | | Agree. |
| • Set after taking into account Input Methodology determined pass-through costs and recoverable costs. | | | | | MEUG has today made a separate submission to the Commission on pan industry Input Methodologies. In that submission MEUG comments on proposed pass-through and recoverable costs for Transpower. |
| • Set without provision for wash-ups. | | | | | Agree. |
| Actual operating expenditure allowances excluding pass-through costs and recoverable costs are: | | | | | |
| Period | RCP1: Transition year | | RCP1: Remainder Period (4 years) | RCP2 and future RCP (each 5 years) | |
| Years ending June | | 2012 | 2013 to 2015 | 2016 to 2020 | |
| Operating expenditure | Settlement base (CPI-0) | $225.10m | To be assessed prior to start of | To be assessed prior to start of | MEUG does not support the proposed operating expenditure allowance of $231.67m for the Transition year because: |

<table>
<tr><th colspan="5">Draft Reasons</th><th>MEUG comments</th></tr>
<tr><td rowspan="5">Allowance</td><td></td><td></td><td rowspan="5">regulatory period.</td><td rowspan="5">regulatory period.</td><td rowspan="5">• Consumers should not have to pay the proposed increase in costs of $8.9m given the Commission acknowledges it “has not undertaken a full review of the planned maintenance cost increase of Transpower's capability to carry out the works ...” (paragraph 4.3.10). If Transpower cannot provide information to satisfy the Commission that it needs this cost increase, then the need for the increase must be subjective. By accepting a subjective view from Transpower the Commission is showing bias in favour of Transpower at the expense of consumers. This is contrary to the Part 4 purpose statement.<br>• MEUG does not agree Commission levies and IR costs should be treated as Recoverable Costs.<br>The net result is MEUG recommend the Commission set an operating expenditure allowance for the Transition year of $222.77 million.<br>Agree operating expenditure allowance for the Remainder Period and RCP2 and future RCP should set prior to the start of those regulatory periods.</td></tr>
<tr><td>Increase proposed by Transpower (not validated by the Commission)</td><td>+$8.90m</td></tr>
<tr><td>Commission levies now treated as pass through</td><td>-$0.78m</td></tr>
<tr><td>IR costs now treated as Recoverable Costs</td><td>-$1.55m</td></tr>
<tr><td>Proposed allowance</td><td>$231.67m</td></tr>
<tr><td>Incremental Rolling Incentive Scheme (IRIS)</td><td colspan="2">Does not apply</td><td>Will apply</td><td>Will apply</td><td>Agree IRIS should not apply in the Transition Year<br>MEUG has today made a separate submission to the Commission on pan industry Input Methodologies. In that submission MEUG comments on proposed IRIS for Transpower. In summary MEUG supports an incentive scheme; however a scheme that is biased towards the interests of Transpower is not acceptable.</td></tr>
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| **Chapter 5: Capital Expenditure** | |
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| Capital expenditure input methodology may need to be amended following the Commission reviewing the approval methodology once the Electricity Industry Bill is passed into law. | Noted. |
| Minor capital expenditure allowance for the Transition period of $225.6 million with ex-post approval only for exceptional circumstances. | MEUG does not support this proposal. It remains incongruous the Commission can on the one hand claim that (paragraph 5.5.8):<br>“Commission remains somewhat concerned about Transpower's history of under-delivering capital expenditure and its capacity to increase its delivery of Minor capital expenditure to the levels proposed” |

| Draft Reasons | MEUG comments |
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| | And on the other hand once again gives the benefit of the doubt to Transpower.<br><br>MEUG notes a significant change by the Commission to the proposed level of substitutability within programme approved allowances and between programmes compared to the proposals discussed at earlier Commission workshops.<br><br>MEUG is not confident the level of operational flexibility this gives Transpower will lead to efficiency gains. With the acknowledged poor approval processes within Transpower there is a good chance resources will be spent on work that would not meet the demands of a proper approval process. This would lead to inefficient expenditure being funded by consumers and therefore contrary to the purpose of Part 4. |
| Over time the Commission will move to a fully ex-ante approval basis. This will be achieved by progressively evolving the approval process for minor capital expenditure towards a fully ex ante basis in the Remainder Period and then RCP2. | Agree with progressive shift to a fully ex ante basis provided have confidence Transpower have the processes and resources to achieve this.<br><br>MEUG is not confident Transpower has demonstrated it can make those changes in a timely manner. Comments above on the risk to consumers for the proposed level of substitutability for minor capital expenditure in the Transition period apply equally to the Remainder Period. |
| Major capital expenditure to be included in MAR: | |
| • Anything not classified as minor capital expenditure is classified as major capital expenditure. | Noted. |
| • Prior to 1st October 2010 must have been approved under Part F of the Electricity Governance Rules. | Noted. |
| • Between 1st October 2010 and 30th September 2011 must have been approved by the Commission using the carried over Part F Electricity Governance Rules process. | Noted. |
| • From 1st October 2011 must have been approved by the Commission will use a new process to be consulted on and decided over 2011. | Noted. |
| • There will be no ex-post approval of major capital expenditure items. | Agree. |
| • There will be no ability to substitute approved amounts between major capital expenditure items in RCP1. This may be reviewed for RCP2. | Agree. |

| Draft Reasons | MEUG comments |
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| **Chapter 6: Quality Standards** | |
| Incentives and penalties for good and poor performance respectively should be symmetrical. | Agree. |
| For RCP1: | |
| • Quality standards for future RCP's based on prior five years actual performance with caps and collars at 2 standard deviations. | MEUG notes the Commission is keeping an open mind on other spreads for setting caps and collars such as one standard deviation (paragraph 6.5.1 b.). |
| • The incentive and penalty scheme will be monitored and reported but no revenue gain or loss will be implemented. This will assist gain experience ahead of RCP2. | Agree. |
| For RCP2 and onwards the incentive and penalty scheme will be set prior to the start of Transpower's first pricing year for each RCP. The scheme need not use the same measures and weights as RCP1. | Agree. |