

28 February 2019

Dane Gunnell
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Regulation Branch
Commerce Commission
By email to regulation.branch@comcom.govt.nz

Dear Dane

Transpower's IPP for the next RCP – Issues paper

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission issues paper "Transpower's individual price-quality path for the next regulatory control period" (IPP for next RCP), dated 7th February 2018.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.

Quality standards and performance measures and Asset management

3. Attached and to be read as part of this submission is an independent expert report from Mike Hensen of NZIER, Transpower IPP 2020-25 – Comment on Issues Paper, 25th February 2019. A snap shot of the executive summary of the NZIER report follows:

Key points

Transpower's development of its proposed revenue incentives for improving service quality has included consultations with customers (grouped according to economic impact of an outage) about a selection of price/service level options and about the value of lost load. However, it is not clear how much of the consultation on economic impact on customers and value of lost load (VoLL) has been carried through into the recommendations on the revenue at risk. In particular:

- the modelling used to allocate the incentives both between customer groups and within customer groups between number and duration of outages is unclear; and
- the proposal to increase the revenue at risk is not supported by an explanation of either what Transpower can do to change the number/duration of outages or how the incentive encourages that action to be taken.

¹ URL https://comcom.govt.nz/_data/assets/pdf_file/0023/120785/Transpower-IPP-reset-Issues-paper-7-February-2019.PDF at <https://comcom.govt.nz/regulated-industries/electricity-lines/electricity-transmission/transpowers-price-quality-path/setting-transpowers-price-quality-path-from-2020>

4. MEUG welcomes the Commission noting Transpower has taken steps over RCP to improve its asset health and condition assessment practices and understanding of asset criticality across the asset fleet.² MEUG agrees with the Commission that more work is needed.³ MEUG is frustrated that:
 - a) Over RCP2 Transpower has earned an economic rent as if it has been performing at best practice when, if it were operating in a competitive market, it would not earn full WACC; and
 - b) The proposed preferred option by the Commission to require an independent verification part way through RCP3 to report progress in this area seems to us to be a continuation of the weak incentives to date leading to delays in RCP1 and RCP2 from making real progress.⁴
5. MEUG recommends the Commission strengthen the outcomes of the proposed mid-RCP3 progress report and end of RCP3 deliverables with financial incentives, namely financial penalties if pre-defined benchmark steps are not met. The mid-RCP benchmarks should be set to ensure completion of best practice asset management processes for the AMP that will inform the price-quality path for RCP4. If Transpower fails to achieve predefined final outcomes for the end of RCP3, then Transpower's owners should bear material financial penalties. We think in this case the ends-justify sufficiently strong penalties to motivate the Board and management to complete this work. There may be other ways to achieve the same outcome and we look forward to cross-submissions from other parties. MEUG would be interested to know if any other party believes an expectation of completion of asset criticality and asset health work before end of RCP3 is unreasonable.⁵
6. The issues paper does not discuss the point we made in our last submission when commenting on the complexity of determining asset criticality for "Transpower and distributors to improve how they uncover end consumer preferences including the use of more rather than less sophistication and granularity of tariffs."⁶ We are unsure if the Commission believes that point is relevant or not, and if irrelevant, why? The benefit of and therefore the need for Transpower to provide more granular forecast price effects is discussed later in this submission in paragraph 11 in relation to suggestions from MEUG not taken up in the Capex Input Methodologies review that should be considered for improvements in Transpower's Information Disclosure requirements.
7. NZIER's report for MEUG of 14th December 2018 submitted to the Commission in the Default Price-Quality Path (DPP) cross-submission round, in relation to the revenue at risk for the DPP reset, noted:⁷

"... the revenue at risk percentage set as an incentive to improve reliability and the cap/collar should be set for individual EDB so that they match the benefit to customers indicated by VoLL."

MEUG recommends the Commission consider applying the same approach for relevant Transpower performance measures.

² Issues paper summarised on paragraph X19.

³ Ibid, summarised in paragraph X20 to X22.

⁴ Ibid, CC preferred approach summarised in paragraph X23.

⁵ Need to complete this work was covered in the MEUG submission on Process, Framework and Approach paper, 18 November 2018, refer <http://www.meug.co.nz/node/961> (the "prior MEUG submission"), paragraph 4 a).

⁶ Ibid paragraph 4 b).

⁷ Found at <http://www.meug.co.nz/node/972>

Revenue path

8. The discussion on the Commissions firmed up preference for revenue smoothing over all 5-years of RCP3 makes no mention of whether the point raised previously by MEUG of the benefit of annual public scrutiny was considered.⁸ Given uncertainty and potential complexity around the treatment of inter-RCP smoothed revenue paths and no argument rebutting our prior view that annual public scrutiny is beneficial, MEUG therefore has shifted its position from being open-minded to now opposing revenue smoothing. To shift MEUG back to being neutral or supporting revenue smoothing we would need a cost-benefit-analysis of savings in costs to Transpower that will flow to consumers versus qualitative factors such as the benefit of annual public scrutiny in retaining the status quo.

Customer engagement

9. Chapter 4 is, in our view, a reasonable assessment of Transpower's customer engagement over RCP2 and in preparing the proposal for RCP3. There was consultation with MEUG and MEUG members though it seemed ad hoc and as the paper notes, some consultation was at the last minute and it's questionable if material feedback at that late stage could have been incorporated into changes to the draft RCP3 proposal. A further example of last minute or lack of consultation before the RCP3 proposal was lodged was on the VoLL papers dated June and published in November 2018.
10. Referring to the question in paragraph 4.36, MEUG does not consider Transpower tested with customers the price-quality trade-off that we would expect from any business including capital intensive enterprises, in a workably competitive market.
11. MEUG supports further consideration of the changes to the information disclosure (ID) requirements in paragraphs 4.30 and 4.31.⁹ MEUG proposed in the Capex Input Methodology (IM) review more extensive information disclosure requirements for major capex and listed projects. For example, requiring Transpower to identify and explain differences between beneficiaries and the parties that will pay for those projects and customer consultation. We suggest those proposals not adopted in the revised Capex IM be reconsidered for improving Transpower's Information Disclosure requirements.¹⁰ MEUG recommends work on improving Transpower's Information Disclosure requirements be initiated this year as provisional decisions on the IPP proposal start to firm up. Looking forward to the RCP4 proposal, the ideal outcome would be for Transpower to prepare that proposal based on best practice Asset Management Practices integrating asset criticality and asset health measures along with feedback from informed end consumers on major capex and listed project consultations in RCP3 that require more granular quality and price/cost effects. To achieve that will require early commencement of a review of Transpower's Information Disclosure requirements.

⁸ MEUG prior submission paragraph 4 e).

⁹ Response to question in Issues Paper, paragraph 4.36.3.

¹⁰ For example, MEUG submissions to the Commission:

- 14th June 2017, complimentary or alternative solutions, paragraph 18, <http://www.meug.co.nz/node/852>
- 8th December 2017, section headed "Expected benefits and impact of proposed investments on transmission charges, <http://www.meug.co.nz/node/891>
- 16th January 2018, sections headed "IPP proposal should contain detailed option analysis" and "Transpower also, should publish more granular forecast price effects for base capex", <http://www.meug.co.nz/node/900>
- 16th April 2018, paragraph 3 a), <http://www.meug.co.nz/node/927>

RCP3 period

12. In the prior consultation on process, framework and approaches MEUG suggested that given multiple uncertainties the Commission and Transpower should consider a shorter duration RCP of 4 rather than 5-years.¹¹ The issues paper has not considered that suggestion.

Recognition of the value of the Verifiers report

13. An important context for this submission is MEUG's acknowledgement of the excellent work and value added by the independent Verifier to the IPP application process to date. The actual output of the Verifier has assisted MEUG have more confidence use of a verifier for future IPP resets outweighs any potential loss of interaction and understanding by the Commission of what drives Transpower.¹²

Yours sincerely



Ralph Matthes
Executive Director

¹¹ Prior MEUG submission paragraph 4 c).

¹² Prior MEUG submission paragraph 4 f).