



16 January 2018

Keston Ruxton
Regulation Branch
Commerce Commission
Wellington
By email: regulation.branch@comcom.govt.nz

Dear Keston

Capex IM draft decisions cross-submission

We appreciate the opportunity to respond to submissions to the Commerce Commission's draft determination of the Capital Expenditure Input Methodology (Capex IM). At this final stage of the submissions process for the Capex IM, we would like to recognise and thank stakeholders for their participation. Understanding stakeholder concerns assists us to identify opportunities for improvement.

We respond to the other two submissions to the Commission's draft decisions, from Major Energy users group (MEUG) and Contact Energy (Contact), in turn below.

Major Energy Users Group

MEUG identified explicit support for two changes:

- the Commission's proposal for transmission charges information (and MEUG proposed additional prescription for the scope and format of potential charges information), and
- base capex enhancement and development (E&D) funds that depend on a demand trigger (MEUG noted the approach may not be a trivial exercise).

Our views on both proposals are outlined in our submission to the draft decisions.

We explained that the process issues to estimate transmission charges linked directly to base capex project or programmes, makes the proposal unreasonable. We consider voluntary, responsive engagement with our stakeholders, rather than imposing new obligations, will better support development of relevant and useful transmission charge information.

We strongly opposed the Commissions' proposal for a demand trigger for base capex E&D (waiting until a certain level of demand is reached to obtain additional expenditure). We note MEUG's view of the benefit of "considering forecast demand uncertainty across all E&D proposals in a consistent and integrated approach ahead of a RCP". We consider our proposal, which MEUG is now aware of via our submission, will better support that intent.

During our review of the submissions from MEUG and Contact, we have been able to reflect further on the efficacy of the E&D demand trigger in light of Contact's views on transmission alternatives.¹ We discuss our conclusion in the section below.

Contact Energy

Contact provided views including:

- advocacy for new base capex obligations for transmission alternatives
- rejecting a threshold change for 'other base capex' from \$1m to \$5m, and
- the Commission's approach to regulatory decision making.

First, as introduced above, we address the interaction of the proposed E&D demand trigger with consideration of transmission alternatives. We conclude that the policies do not work together, and the demand trigger constraint could be detrimental to consideration of transmission alternatives. The reactive nature of the demand trigger will reduce the amount of time available to consider all options for the reliability investment. In contrast, our proposal to manage uncertainty (as covered in our submission to the draft decisions) will create more opportunities to consider transmission alternatives, because E&D needs arise from a broader range of drivers than solely demand growth.

New base capex obligations Contact continues to advocate for new obligations to consult across all base capex for transmission alternatives, stating *"Transpower has demonstrated that it will not do this [consultation] without being required to. The incentives for it to do this have been shown not to exist."*² We disagree with Contact's view that no incentives exist for our consideration of transmission alternatives. If the use of transmission alternatives promises to reduce the cost of delivering our grid service, then our commercial incentive is to pursue those.

We also do not share the view that we will not consult unless obliged to. As previously submitted³, we continue to work on improving our communication and engagement with stakeholders. We use multiple channels such as our existing information disclosure documents⁴, annual report, stakeholder and industry events. Our reputation relies on positive and responsive stakeholder interaction.

We agree with the Commission's view, highlighted by Contact, that *"a greater focus on effective consultation would allow for a wider variety of investment options, enhance protection for consumers against inefficient investment, and ensure the full benefits of innovation in the electricity industry are realised."* The key word is 'effective'.

We consider effective means the consultation will be efficient, practical and useful for all parties. As submitted to the Commission's draft decisions, we *"consider projects with scope for several options and with cost uncertainty (such as grid enhancement and reconductoring projects) benefit from a diversity of input. We agree with the Commission's expectation that replacement and refurbishment projects⁵ are less likely to provide opportunities for alternative solutions than enhancement projects."*⁶

¹ We use the term *transmission alternatives* for base capex. *Non-transmission solutions* is a defined term only for major capex processes.

² [Contact Energy](#) submission 8 December 2017 Paragraph 19

³ [Transpower submission](#) incentive mechanisms 22 September 2017

⁴ Integrated Transmission Plan (ITP) comprising Transmission Planning Report (TRR), Asset Management Plan (AMP) and service report (quality) available at www.transpower.co.nz

⁵ For example, tower painting, circuit breaker replacement and insulator replacement.

⁶ [Commission's consultation](#) on incentive mechanisms, paragraph 64.

Finally, we argued that the cost of broad consultation obligations across **all** base capex needs to be weighed against the likelihood that fit for purpose, economic transmission alternatives may emerge anyway.⁷ **As the transmission alternatives market evolves, we welcome engagement with providers to understand the value proposition of their services to assist reliability obligations.**

Increase in threshold (from \$1m to \$5m) for ‘other’ base capex We consider Contact’s concern is unfounded as it has misinterpreted the significance of the change. Our base capex proposal for each regulatory control period is governed by schedule F of the Capex IM. Clause F6 outlines information required on base capex programmes and covers a large part of our proposed base capex, including E&D expenditure. The clause has no threshold so can capture investments in the \$1m - \$5m range for which transmission alternatives may be an option.

Currently clause F9 requires a description for any remaining base capex over \$1m that is not captured by programmes in clause F6. In our proposal for RCP3, we consider clause F9 should not capture E&D investments for which transmission alternatives may be an option. The increase of the threshold from \$1m to \$5m, as requested by Transpower, is intended to reduce the administrative burden of describing reasons for low value expenditure not attached to any other investment programme.

Commission’s approach to regulatory decision making We disagree with Contact’s view (para 16) that *“the Commission’s approach to wait for evidence of a problem or a market failure before acting is at odds with its regulatory peers, and is a passive way for a regulator to go about regulating the industry in the way the Act requires.”* We consider a fundamental precursor to sound policy-making, and the regulation that may result, is to seek evidence of a problem or market failure. Seeking evidence is not passive and requires the regulator to operate proactively and methodically.

The High Court IMs Merit Appeal decision highlighted the importance of ensuring evidence-based decision making rather than relying on subjective judgement.⁸ We consider the approach to regulation that Contact argues for would lower the bar needed to justify new regulation, result in increased regulatory risk and create uncertainty for other market participants and consumers.

If you have queries relating to our Capex IM submissions, please contact Micky Cave (04 590 7309).

Yours sincerely

Catherine Jones

Regulatory Affairs and Pricing Manager

⁷ [Transpower submission](#) incentive mechanisms 22 September 2017

⁸High Court Judgment [2013] NZHC 3289 Part 4 of the Commerce Act 1986 Appeals under s 52Z of input methodology determinations of the Commerce Commission.