

22<sup>nd</sup> October 2013

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By email: [submissions@ea.govt.nz](mailto:submissions@ea.govt.nz)

Dear Androula

## **Appropriations 2014/2015**

Thank you for the opportunity to submit on the paper *2014/15 Levy-Funded Appropriations, Electricity Authority Work Programme, and EECA Work Programme*, published 10<sup>th</sup> September. Our interest in this matter is as Grid Owner and System Operator.

### **Support broad focus of work**

We are generally supportive of the work programme outlined in the consultation paper. We consider that it is right to focus on enablers of effective retail competition. In practice the NZ market remains a challenging environment for independent retailers. Vibrant competition in the retail market, in particular from independent retailers, provides choice, can drive innovation and exert demand side pressure on costs.

### **An ambitious work programme**

The Authority has a very full work programme – at last count there are 48 separate initiatives some of which, e.g. the TPM investigation, are significant undertakings. We support an ambitious and motivated regulator however we are all too aware that, in pursuing a large number of interdependent initiatives in an evolving market, priorities can change dynamically.

We support the direction of the 2014-17 work programme (which we acknowledge has been informed by joint planning with the SO). We note, however, that in some cases the timelines indicated for project implementation are tighter than is currently contained in the joint work plan. We also consider that it would be helpful if the assessment of size and net public benefit were attributed to each project (not just the programme category). This would assist with prioritisation and resource allocation.

We agreed with the Authority's statement at C3 that "The market performance and compliance monitoring roles will assist with identification of issues requiring further attention in the market work programme". We were surprised, given that statement and the importance of compliance to the success of regulatory interventions, that no projects are identified in the Compliance programme.

We encourage the Authority to continually reflect on the value of existing initiatives to ensure current prioritisation is appropriate and to cull or defer low value initiatives. This exercise should take account of the implications of each initiative for affected parties – in the development and implementation stages - recognising many initiatives are competing for the same resources. Deprioritising or culling low value initiatives will also assist decision quality. The reality is that the Authority has limited resources and if it attempts to do too much there will inevitably be degradation in quality. An overstretched Authority will also struggle to retain a strategic view of opportunities and risks.

### **Better explanation of System Operator costs**

Due to the central role of the System Operator (SO) in the industry, and as enabler of many of the Authority's market development initiatives, the SO costs are a significant proportion of the EA's levy funded appropriation. It is natural therefore that its costs attract attention and scrutiny – in particular when they are flagged as the driver behind an increased appropriation.

It is important that interested parties understand how these costs are composed, their key drivers and how they translate into the appropriation figure. We think it helpful to briefly explain that the SOSPA (the governing agreement between the SO and the Authority) sets the SO's expenditure as follows:

- operating expenditure fixed in real terms at \$22.8m (adjusted for CPI)
- capital expenditure allowances are based on a three-year capex plan; and
- actual capital expenditure is reflected in adjustments to revenue via a three-year 'wash-up' mechanism.

The increase in SO costs outlined in the consultation paper is principally due to higher capital costs. Those capital costs are driven by the need for the SO to support the Authority's market development agenda. While not trivial these costs are relatively small in the scheme of the benefits that the market development agenda is expected to unlock.

Transpower's 2012/13 annual regulatory report<sup>1</sup> (ARR) to the Commerce Commission, which was published this week, includes updated cost and revenue forecasts and supporting commentary. The commentary contrasts typical SO asset lifetime with grid assets and explains the implications for accounting and tax depreciation (and revenue). The ARR together with the SO report "Capex Discussion<sup>2</sup>" provide a more in depth view of SO activities and cost drivers.

Note: while the information relating to the SO in the ARR is a voluntary disclosure the Commerce Commission is currently consulting on information disclosure for Transpower and the SO3.

### **Institutional frameworks and practices**

Finally, we support the Authority's vision is to be a world class regulator<sup>4</sup> but recognise that it is easier said than done.

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<sup>1</sup> See: [https://www.transpower.co.nz/sites/default/files/publications/resources/annual-regulatory-report-2012-13\\_0.pdf](https://www.transpower.co.nz/sites/default/files/publications/resources/annual-regulatory-report-2012-13_0.pdf)

<sup>2</sup> See: [http://www.systemoperator.co.nz/f1688,86103459/20130625\\_CAPEX\\_Discussion\\_Document.pdf](http://www.systemoperator.co.nz/f1688,86103459/20130625_CAPEX_Discussion_Document.pdf)

<sup>3</sup> See: <http://www.comcom.govt.nz/regulated-industries/electricity/electricity-transmission/transpower-information-disclosure/>

The following attributes and practices are demonstrated by well-regarded regulators:

- adopting regulatory 'principles' to which the regulatory authority will hold itself and be willing be held accountable to by others
- deploying 'best practice' regulatory policy development frameworks including to manage tensions between policy objectives, risk, uncertainty (and so on)
- using a consistent and structured approach to cost benefit analysis
- publishing decision papers containing the reasons for individual decisions
- reviewing established regulation to verify whether it has had the intended effect, and whether it should revise, retain or remove the regulation.

These attributes and practices help create robust decisions and an ecosystem or virtuous circle of enhanced regulatory quality, reduced dispute and rework (and associated cost and stress). These benefits make the Authority's aspiration a worthy one that warrants dedicated resources and Board level attention on an on-going basis.

We have responded to the questions at Appendix A. If you have any questions about our submission please contact me ([jeremy.cain@transpower.co.nz](mailto:jeremy.cain@transpower.co.nz) 04 590 7544).

Yours sincerely

A handwritten signature in black ink, appearing to be 'JC' followed by a long horizontal stroke.

Jeremy Cain  
**Chief Regulatory Advisor**

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<sup>4</sup> See: <http://www.ea.govt.nz/about-us/structure/vision-values-mission/>

## Appendix A - Response to Consultation Questions

Table 1

Responding to:	Response
1. The overall proposed Electricity Authority appropriations as set out in table 1 of the consultation paper	<p>We accept the proposed appropriations.</p> <p>We consider that information about cost drivers would add context for the reasons for changes in service providers costs.</p>
2. The proposed changes to Authority appropriations	We accept these.
3. Other key matters relating to the Authority's overall appropriations that you consider the Authority should address	<ul style="list-style-type: none"> <li>• TPM working papers – problem definition and options.</li> <li>• Data analysis and models to evaluate market initiatives to date.</li> </ul>
4. Your level of support for the overall work programme as outlined in the consultation paper	We generally support the work programme outlined in the consultation paper.
5. Comments on the overall programme	<p>The programme is very full – at last count there are 48 separate initiatives some of which, e.g. the TPM investigation, are significant undertakings.</p> <p>We consider that it is right to focus on enablers of effective retail competition. In practice the NZ market remains a challenging environment for independent retailers. Vibrant competition in the retail market, in particular from independent retailers, provides choice, can drive innovation and exert demand side pressure on costs.</p> <p>We support the direction of the 2014-17 work programme (which we acknowledge has been informed by joint planning with the SO). We note, however, that in some cases the timelines indicated for project implementation are tighter than is currently contained in the joint work plan</p> <p>We were surprised, given the importance of compliance to the success of regulatory interventions, that no projects are identified in the Compliance programme.</p> <p>We encourage the Authority to continually reflect on the value of existing initiatives to ensure current prioritisation is appropriate and to cull or defer low value initiatives. The reality is that the Authority has limited resources and attempting to do too much inevitably impacts on quality.</p>