



COMMERCE COMMISSION

Please refer to:

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13 March 2009

Hon Gerry Brownlee
Minister of Energy and Resources
Parliament Buildings
Wellington

Dear Minister

**Government Policy Statement on Electricity Governance - Commerce Commission
Comments**

Thank you for your letter dated 2 March 2009 seeking the Commerce Commission's comments on the revised draft Government Policy Statement on Electricity Governance dated February 2009 (Draft GPS). Your letter states that the revisions within the Draft GPS fall into the following three broad categories.

- The priority the Government accords to security of supply policy.
- The Government's desire to facilitate small grid upgrade investments by streamlining the investment approval process.
- Removing references to the New Zealand Energy Strategy (NZES) and New Zealand Energy Efficiency and Conservation Strategy (NZECS).

The Commerce Commission has considered the revisions contained in the Draft GPS. The Commerce Commission has no comments on the revision that emphasises the priority the Government accords to security of supply policy or the revisions that remove the references to the NZES or NZECS.

The Commerce Commission comments on the new subsection entitled 'Investment in Minor Transmission Works' within the Draft GPS are set out below.

Commerce Commission obligations under Part 4 of the Commerce Act

The Commerce Commission has responsibilities under Part 4 of the Commerce Act 1986 specifically in relation to suppliers of electricity lines services, including suppliers of transmission services (Transpower).

Section 52A of Part 4 of the Commerce Act provides that the purpose of the regulatory regime is to promote the long-term benefit of consumers in regulated markets by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services:

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- have incentives to innovate and invest, including in replacement, upgraded and new assets; and
- have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and
- share with consumers the benefits of efficiency gains in the supply of the regulated goods of services, including through lower prices; and
- are limited in their ability to extract excessive profits.

The Commerce Commission must set price-quality requirements consistent with section 52A of the Commerce Act and monitor compliance by regulated suppliers against these requirements.

The Commerce Commission is required by section 26 of the Commerce Act to have regard to the economic policies of the Government as transmitted in writing from time to time to the Commerce Commission. In contrast, the Electricity Commission is required by section 172ZK of the Electricity Act to give effect to the objectives and outcomes in the Government Policy Statement.

Commerce Commission role in relation to Transpower

On 13 May 2008, the Commerce Commission accepted an administrative settlement from Transpower in respect of breaches of the thresholds under Part 4A of the Commerce Act. Under subpart 9 of Part 4 of the Commerce Act, as amended by the Commerce Amendment Act 2008, Transpower continues to be subject to its administrative settlement until its expiry date of 30 June 2011.

The existing administrative settlement between the Commerce Commission and Transpower allows any capital investment approved by the Electricity Commission under the procedures in Part F of the Electricity Governance Rules and commissioned to be added to the Transpower regulatory asset base, which in turn is used to calculate future revenue requirements. The Commerce Commission does not conduct an independent review of Electricity Commission approved capital expenditure as part of the existing administrative settlement.

The Commerce Commission's decision to include Transpower's capital expenditure in the regulatory asset base, once it is approved by the Electricity Commission, was based upon the alignment between the existing Electricity Commission capital expenditure review and approval approach under Part F of the Electricity Governance Rules and the Commerce Commission's obligations under the Commerce Act.

Proposed addition to GPS - 'Investment in Minor Transmission Works'

Approval of capital expenditure

We understand that the addition of the new subsection entitled 'Investment in Minor Transmission Works' within the Draft GPS relates to the Electricity Commission's approach and approval of Transpower's capital expenditure only. The proposed change to the GPS may require the Electricity Commission to consult on and change the approach it applies to the review and approval of Transpower's capital expenditure. Any changes to the Electricity Commission capital expenditure approval process would require the Commerce Commission to consider whether the level of regulatory oversight applied to Transpower's capital expenditure continues to meet the Commerce Commission's obligations under Part 4 of the

Commerce Act. This in turn may necessitate the Commerce Commission consulting on the treatment of Transpower's capital expenditure that has been approved by the Electricity Commission. The Commerce Commission cannot pre-determine what the outcome of such a consultation process would be.

Coverage of Investment in Minor Transmission Works

The Commerce Commission notes that the new subsection entitled 'Investment in Minor Transmission Works' within the Draft GPS refers to both 'maintenance of the transmission network' and to 'all future small projects which cost less than \$20m' (paragraph 87 and 88 respectively).

Minor works that extend asset life times or enhance the service potential of assets (such as refurbishment, replacement or enhancement) are considered to be capital expenditure. On the other hand minor works that simply maintain the life or service potential of an asset are considered to be operating expenditure.

Within the existing administrative settlement between the Commerce Commission and Transpower, the determination of the Transpower operating expenditure (maintenance) for the duration of the settlement was provided for through an inflation-adjusted allowance based on a Commerce Commission approved 2006 baseline. The Electricity Commission was not involved in reviewing or setting operating expenditure for the Transpower administrative settlement and the Electricity Governance Rules are not currently designed to accommodate the review or approval of operating expenditure.

Under the existing Transpower administrative settlement the review and approval of the Transpower capital expenditure is split between the Electricity Commission and the Commerce Commission. The Commerce Commission is responsible for the review and approval of capital expenditure (defined as non-Part F capital expenditure in the administrative settlement) on any of:

- replacement and asset refurbishment of existing transmission assets;
- minor enhancement and development of transmission assets below \$1.5m and new work programmes having an expected total cost below \$5.0m; or
- operational network information and technology services (IT).

The Commerce Commission review of non-Part F capital expenditure focuses on whether Transpower's capital expenditure forecasts have been prepared by targeting appropriate least-cost, efficient, interventions. The Commerce Commission does not undertake a full technical review of individual projects. The Commerce Commission either approves Transpower's proposed non-part F capital expenditure threshold or sets an alternative, based on efficiency factors. Transpower retains the discretion to prioritise, defer, bring forward, add or remove projects, under the total threshold amount.

In considering whether the existing process places any constraint on Transpower's ability to engage in efficient works such as replacement or refurbishment, we note that for the 2007/08 financial year Transpower's actual non-Part F capital expenditure threshold was set at \$120.7m, of which only \$81.2m was spent by Transpower. For the 2008/09 financial year, the non-Part F capital expenditure threshold was set at \$203m. As at 31 January 2009 of the 2008/09 financial year, Transpower has only spent \$42m compared to a budgeted expenditure of \$112.7m for that seven month period.

The reference to 'all future small projects' in paragraph 88 could be interpreted to cover capital expenditure currently reviewed and approved by the Commerce Commission under non-Part F and not just projects under \$20m reviewed by the Electricity Commission under Part F.

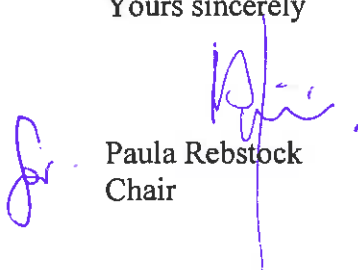
Other Comments

The Draft GPS could be reviewed to ensure that the new section on investment in minor transmission works is consistent with the rest of the Draft GPS. For example, the terms Electricity Commission or Commission and the terms grid upgrade plans, upgrade plans or small investment plans could be reconciled, and paragraph 81 could be amended so that it does not cover grid upgrade plans for projects under \$20m.

Paragraph 109 could be updated to reflect the fact that the Memorandum of Understanding between the Commerce Commission and Electricity Commission has been reviewed and updated.

Should you require further assistance please do not hesitate to contact me.

Yours sincerely



Paula Rebstock
Chair