Pre reading from the Commerce Commission

- What Transpower proposed for DR in its RCP2 submission and what the Com Com's final decision was - and the expectations that they had for the trial

    - *Please see paras 5.173 to 5.185 here:* https://comcom.govt.nz/__data/assets/pdf_file/0025/78541/Setting-Transpowers-individual-price-quality-path-for-20152020-final-decisions-and-reasons-2014-NZCC-23-29-August-2014.pdf

- What Transpower proposed for DR in RCP3 and the Com Com's decision

    - *Transpower did not explicitly propose anything in relation to DR in its RCP3 expenditure proposal. This is to be understood in the context of opex allowances being fungible, so DR can get funded from opex even if it was not earmarked in Transpower's proposal.*

- What the Com Com's expectations are for DR in RCP3 [regulatory control period] (as a non-network option in the Grid Investment Test) and how consumers will benefit

    - *This paper prepared for IPAG provides an overview of our approach to regulation. IPAG members may find it helpful to frame some of our answers to what follows:* https://www.ea.govt.nz/dmsdocument/24201-commerce-commission-paper-on-incentive-regulation

    - *We are a-priori neutral on whether – or the extent to which – Transpower uses DR. Our main focus is ensuring the regime provides incentives to Transpower to invest and operate efficiently. The regime does that by aligning the interests of Transpower with those of consumers (ie finding cost-reducing efficiencies increase profits but also result in lower prices for consumers).*

    - *Our expectation is that Transpower uses DR where this is the optimal choice (ie lowest expected lifetime cost). For example, where the use of DR defers or avoids more expensive capex projects, then Transpower retains a proportion of the capex cost savings as increased profits, and the remainder gets passed through to consumers at the following reset, in the form of lower allowed revenues for Transpower.*

- Spotlight - how the Commission thinks about Transpower's allocation of the costs it incurs in delivering its DR programme and any other (unregulated) uses it puts the platform to

    - *<u>DR-related costs</u>: where these costs are incurred in procuring network support services (eg deferring capex through DR), it is appropriate that they are allocated to the regulated service*

    - *<u>Costs related to other unregulated activities</u>: where Transpower engages in unregulated activities, then those costs should not be allocated to the regulated service. We are not currently aware that Transpower engages in unregulated activities with one exception: performing the System Operator (SO) functions, which is not part of the regulated service. That is why the SO is not funded through the same allowances as the Transmission Owner functions.*

    - *Transpower's regime does not have the same cost allocation rules as those applying to EDBs. Historically, Transpower has not engaged in unregulated activities (except the SO* *functions). We continue to monitor this and plan to review the rules in our next Input Methodologies (IM) Review, which will likely start in 2021 and needs to finish by the end of 2022. We are keen to understand if there are reasons to give this consideration in advance of the IM Review (and or RCP4).*

- Concerns and thinking that the Commission may have about competition in the market for flexibility services with a regulated monopoly marketing and fulfilling its own flexibility product in competition with merchant aggregators

    - *Our first order consideration from a regulatory perspective is ensuring that Transpower has incentives to spend efficiently to get the required inputs – this could be DR that is self-supplied or procured from third parties.*

    - *The theory of harm we would use from a competition law perspective is as follows: a potential concern with regulated monopolies operating their own flexibility product in competition with others is that it might create an incentive and ability of regulated monopolies to favour their own products over independently provided aggregated DR services. For instance, a regulated monopoly may refuse to purchase services from independent providers, or make it harder for them supply to them. Such refusals may mean independent providers are constrained in the ability to effectively compete against regulated monopolies' DR products, potentially reducing competition and innovation in aggregated DR services.*

      However, whether foreclosing independent providers in such a way is in the best interests of regulated monopolies would depend on whether the increased profits from such actions (eg, foreclosing provides the regulated monopoly increased market power in aggregated DR services and so increases profits) outweigh the increased capex savings an independent provider may provide (eg, it may be the case that independent providers are more efficient and/or innovative when providing aggregated DR services and so enable more efficient capex).

    - *We note the below Enel X's argument below. Our view is that there is no right or wrong policy setting; it's a trade-off between the net benefits that arise from vertical integration (eg lower transaction and coordination costs) and the net benefits that arise from competition potentially arriving sooner than might be the case (eg innovation and dynamic efficiency).*

      > *"We strongly discourage the sole buyer of DR as a transmission alternative also becoming a competing supplier of that DR. This tends to make commercial suppliers of DR wary of investing in the sector, leading to reduction in both competition and innovation. To avoid impeding the development of a competitive market for DR as a transmission alternative. We strongly encourage: 1. The purchaser of transmission alternative DR refraining from using regulated funding to engage directly in retail consumer acquisition for DR (though it is reasonable for it to deal with direct grid connected entities which approach it)…"*