



TRANSPOWER

Transpower House, 96 The Terrace,
PO Box 1021, Wellington,
New Zealand
Telephone +64-4-495 7000
Facsimile: +64-4-495 7100
www.transpower.co.nz

Howard Cattermole
howard.cattermole@transpower.co.nz

25 November 2011

Nick Russ
Regulation Branch
Commerce Commission
PO Box 2351
WELLINGTON

Dear Nick

Re: Capital Expenditure Input Methodology technical drafting and consequential amendments to the Transpower IM and IPP Determinations

This is Transpower New Zealand Limited's submission on:

- the technical drafting of the Commerce Act (Transpower Input Methodologies) (Capital Expenditure) Determination 2012 ("Capex IM Determination");
- consequential amendments to the Commerce Act (Transpower Individual Price-Quality Path) Determination 2010 ("IPP Determination"), and
- consequential amendments to the Commerce Act (Transpower Input Methodologies Determination) 2010 ("IM Determination").

We appreciate the positive consideration that the Commission has given to Transpower's submission and cross submission on the draft Capex IM Determination, especially with respect to the framework for developing major capital expenditure proposals and the Integrated Transmission Plan. We also commend the open and constructive manner in which the Commission has considered our views throughout the development of the Capex IM.

With respect to the current consultations, the remaining issues for us are:

Capex IM determination

Directors' certification

We do not agree that certification from directors is required to attest to the validity and veracity of the qualitative, quantitative and forecast information supplied pursuant to schedule G. All major capex proposals will come formally from Transpower and adding directors' certification will only add an additional administrative burden, with no corresponding gain, in regard to the approval of our major capex.

Revenue Adjustments (Schedule B)

We are concerned that the Commission can disregard our proposed values for the inputs into the revenue adjustment formulae, without any criteria for alternative determination. This creates regulatory uncertainty, contrary to the purpose of Input Methodologies. Further, such discretion appears to be the feature of an ex-post claw back regulatory regime, contrary to the overarching ex-ante framework. We propose that at the very least the Commission has regard to our views when making a decision on 'appropriate' input values. We would prefer that the Capex IM promoted certainty through criteria for the revenue adjustments, but given

the timing constraint, we propose that the revenue-adjustment framework continues to be developed with the CC perhaps through the production of guidance material.

Evaluation criteria

We have proposed changes to clarify the criteria that the Commission will be certain to consider and also to clarify that the Commission does not have the power to consider criteria that Transpower and other parties are not aware of ex ante. The current wording effectively allows the Commission to consider any criteria it wishes, whether specified in the Determination or not. This is unsatisfactory in terms of regulatory certainty.

Potential penalty if consultation and cost benefit analysis requirements are not "fully met"

The "fully met" requirement is unreasonably onerous. The Commission should be permitted to consider the materiality of any non compliance and the particular circumstances that might apply to a specific project or programme.

Requirement to provide procurement information at a project level

Procurement information for outsourced services should be provided for identified programmes only. Requiring it to be provided at a project level is impracticable because the information will often not be known ahead of time and would be onerous and costly to provide since there are multiple projects.

IPP Determination

Potential for independent assurance report of annual compliance to require audit of descriptive or narrative content

For the avoidance of doubt, it should be made clear that the Independent Assurance Report does not require the auditor to audit the content of any descriptive or narrative component of the annual compliance monitoring statement (and associated information). Not to do so could introduce a degree of subjectivity that could make the audit process very difficult to complete.

Wash-up building blocks should include pass-through and recoverable costs

Wash-ups of pass through and recoverable costs are required. Hence wash-up building blocks for these classes of costs should be included in Schedule E.

IM determination

We have no specific comment regarding the amendments to the IM determination.

Appendix 1 details our more substantial proposed amendments to the Capex IM and the IPP, along with the reasons for these.

Appendix 2 contains a mark-up of the word version of the November draft Capex Input Methodology. We have not provided a mark-up of the IPP or IM.

As always, we are more than happy to discuss any of the issues raised in this submission.

Yours sincerely



Howard Cattermole
Chief Financial Officer

Appendix 1: Issues, proposed amendments and supporting rationale

CAPEX IM Determination

Issue	Proposed amendment	Justification
<p>Part 1 General Provisions actual FX rate</p>	<p>actual FX rate means, in respect of each relevant currency <u>for which it is possible to obtain such information</u>, weighted average exchange rate obtained by Transpower in its foreign exchange transactions for the base capex or major capex in question;</p>	<p>Qualification to allow for possible impracticality in some instances. This matches the “can reasonably be expected to obtain” qualification in the definition of forecast FX rate.</p>
<p>Part 1 General Provisions policies and processes adjustment: after-tax economic loss to penalise Transpower for failing to follow the requirements for consultation and cost-benefit analysis for base capex > \$20M and failing to act in accordance with each relevant policy and process specified in its base capex proposal.</p>	<p>policies and processes adjustment means monetary amount of after-tax economic loss to take account of any base capex project or base capex programme—</p> <ul style="list-style-type: none"> (a) involving forecast capital expenditure of greater than \$20 million in respect of which the requirements of clause 3.2.1 were not <u>fully met in all material respects, having regard to the particular circumstances of a project or programme;</u> (b) in respect of which Transpower has acted otherwise than in accordance with its policies <u>except to the extent that the Commission is satisfied that such policies should not have been followed for a particular project or programme;</u> 	<p>With respect to (a) “fully met” is unreasonably onerous. The Commission should be permitted to consider the materiality of any non compliance and the particular circumstances that might apply to a specific project or programme.</p> <p>There may be circumstances where, in relation to a particular project or programme, a better approach could be adopted than that prescribed in Transpower’s existing policies. The Determination should allow sufficient flexibility to enable Transpower to propose and the Commission to accept such an alternative.</p>
<p>Part 9 9.1.1 Certification of Base Capex proposals</p>	<p>(2) In the case of all information provided in accordance with the regulatory templates <u>submitted as part of the base capex proposal</u>, other than forecast information, no fewer than 2 directors of Transpower must each certify in writing his or her belief that—</p>	<p>Without this qualification, any modification to a regulatory template would appear to require a new directors’ certificate. That would seem to be contrary to the policy intention.</p>
<p>Part 9 Subparts 2 and 3: Certification of Major Capex proposals</p>	<p>With respect to major capex proposals (Subparts 2 and 3 of Part 9), we recommend that independent expert verification or management verification should replace directors’ certification.</p>	<p>In practice, only independent experts or Transpower’s management can provide the verification required. Although superficially more straightforward, directors’ certification invariably relies on advice from Transpower’s management and/or independent experts. Hence, requiring directors to provide a certificate inevitably injects additional expense, time and administrative inefficiency into the verification process. The</p>

		<p>full board would be required to meet and all must be satisfied as to the information being certified. This would require significant meeting time and up skilling of the full board.</p> <p>A more efficient approach is to require the verification to be provided directly by independent experts or Transpower's management.</p>
<p>Schedule B Revenue Adjustments</p> <p>B3 Calculation of annual base capex output adjustment</p>	<p>base capex output adjustment in respect of the revenue-linked grid output measure in question: $l(m-n)$</p> <p>Provided for each revenue linked grid output measure:</p> <ul style="list-style-type: none"> – where “n” is less than the collar amount “n” is to equal the collar – where “n” is greater than the cap amount “n” is to equal the cap 	<p>This alternative means of expression reduces the number of expressions required.</p>
<p>Schedule B Revenue adjustments</p> <p>B1 (2), B2 (2), B3 (2), B4 (5), B5 (2) B7 (2)</p>	<p>B1 (2) For the purpose of subclause Error! Reference source not found., in calculating the amounts or values for one or more of <i>c</i>, <i>e</i>, <i>f</i> and <i>g</i>, the Commission need not use the amounts or values disclosed by Transpower in the base capex annual report and may instead use the amounts or values that it considers are correct in the circumstances, but must have regard to the views of Transpower.</p> <p>Repeat for B2 (2), B3 (2), B4 (5), B5 (2) B7 (2)</p>	<p>This appears to be an ex-post adjustment mechanism that creates uncertainty, contrary both to the ex-ante policy framework and the IM purpose to promote certainty. Further, there are no criteria around their application. We propose that the CC must (at least) have regard to the views of TP in relation to the values assigned to these letters. We would prefer more certainty under the Capex IM around the criteria but understand there are timing constraints on developing the Capex IM in this manner.</p>
<p>Schedule B Revenue adjustments</p> <p>In B4 the value of ‘r’</p>	<p>Specify in B4 that the term ‘r’ may only take a positive value.</p>	<p>Since the draft Capex IM does not provide for the factors that the Commission may take into account in determining these values (see above) then specify this term.</p>
<p>Schedule C Major Capex proposal – evaluation criteria</p> <p>C2 The Commission may have regard to... C3, C4, C5 ditto</p>	<p>For C2, the Commission must have regard to (a) (i) and (ii) and may have regard to the other criteria.</p> <p>For C3, C4 and C5, the Commission must have regard to one or more of the following factors...</p>	<p>To increase regulatory certainty for all parties by clarifying, in the case of C2, which factors the Commission is certain to consider, and for , for each of C2, C3, and C4 and C5 that the Commission does not have the power to consider criteria that Transpower and other parties are not aware of ex ante.</p>
<p>Schedule F Base Capex</p>	<p>F7 Procurement</p>	<p>The requirement that</p>

<p>Proposal – Qualitative Information F7 Procurement.</p> <p>Procurement information is being requested at a projects level</p>	<p>For each <u>identified programme that uses outsourced services that have a material effect on the desired outcome</u></p> <ul style="list-style-type: none"> (a) explain whether those outsourced services are to be provided- <ul style="list-style-type: none"> (i) under a discrete contract; or (ii) as part of a broader operational arrangement or contract (or similar); (b) provide an overview of the procurement process, including an explanation of the extent to which the process was competitive, and if not, why not; (c) identify any significant components of any outsourced services that will be or have been sub-contracted to another supplier; and <p>(2) identify relevant procurement documents in a schedule, including but not limited to requests for tender and submissions in response.</p>	<p>procurement information be provide at a project level is:</p> <ul style="list-style-type: none"> a) impracticable (because the information will often not be known ahead of time); and b) onerous and costly to provide since there are hundreds of projects. <p>We do not believe this requirement is consistent with the policy intent.</p>
---	---	--

IPP Determination

Issue	Proposed amendment	Justification
<p>Planned Outage means an outage as specified in clause 12.130 of the Code, other than an unplanned outage</p>	<p>Planned Outage means an outage as specified in clause 12.130 of the Code <u>excluding sub clauses c) and d)</u> and other than an unplanned outage</p>	<p>Transpower does not currently monitor parts c and d of 12.130 as planned outages. Since the quality standards for RCP1 have been derived from our current practice, we recommend that the planned outage definition be consistent with our current approach to monitoring. We understand this to be the Commission's policy intent.</p>
<p>Part 5 Annual Compliance and Monitoring Statement 5.2 Information requirements applying to price path</p> <p>(4) (b) for each disclosure year, actual performance for all grid output measures (base), as defined in the including background information on the level of performance;</p>	<p>Delete.</p>	<p>This is not the relevant performance measure for RCP1. If not deleted, this provision would require Transpower to report on something not set until RCP2.</p>
<p>Part 5 Annual Compliance and Monitoring Statement 5.2 Information requirements applying to price path</p> <p>4 (d) for each disclosure year, a list of the base capex asset enhancement projects subsequently approved by the Commission as major capex projects, and the resulting adjustments to the approved base capex; and</p>	<p>New clause ... <u>for each disclosure year, a list of the base capex projects subsequently approved by the Commission as major capex projects, and the resulting adjustments to the approved base capex; and</u></p>	<p>A mechanism needs to be created to move projects between base capex and major capex when the investment purpose has changed (e.g. when a replacement modern equivalent asset under base capex becomes an asset upgrade that qualifies it as major capex).</p>
<p>Part 5 Annual Compliance and Monitoring Statement Error in 2011/12 base capex figure at 5.4 (3) (d) (i)</p>	<p>Amend figure under 5.4 (3) (d) (i) from \$248.5 to \$208.6.</p>	<p>Think that the figure \$248.5million indicated for 11/12 Base Capex is the Operating Expenditure allowance under 5.2 (7) (b) (i) \$208.6 is indicated as 11/12 Base Capex at 5.3 (6) (a)</p>

Schedule C – Independent Assurance Report – Annual Compliance	Specify in Schedule C that, for the avoidance of doubt, the Independent Assurance Report does not require the auditor to audit the content of any descriptive or narrative component of the annual compliance monitoring statement (and associated information).	If Schedule C were interpreted to require the auditor to audit the content of descriptive or narrative components of the annual compliance monitoring statement (and associated information) this would introduce a degree of subjectivity that could make the audit process very difficult to complete. We do believe it was the Commission's policy intention to permit such an interpretation.
Schedule E: Wash-Up Building Blocks	The Schedule should provide for wash-up building blocks for pass through and recoverable costs.	Wash-ups of pass through and recoverable costs are required. Hence wash-up building blocks for these classes of costs should be included in Schedule E.

Appendix 2: Marked-up Capex IM Determination
(See document sent separately)