

## **Transpower capex input methodology review**

**Process update paper**

**Date of publication:** 28 July 2017

## Associated documents

Publication date	Reference	Title
28 April 2017	Notice of intention	Notice of Intention – Input Methodology Review: Transpower Capital Expenditure Input Methodology
15 May 2017	Consultation paper	Proposed focus areas for the capex IM review

Commerce Commission  
Wellington, New Zealand

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## Introduction

### Purpose of this paper

1. The purpose of this paper is to update stakeholders on process matters relating to the Transpower capex input methodology review (**capex IM review**). More specifically, it:
  - 1.1 confirms the focus areas for the capex IM review;
  - 1.2 sets out the topics and key issues to be considered as part of the review; and
  - 1.3 sets out the process and the timeline for reaching our draft decision and final decision.

### Background to this paper

2. Input methodologies (**IMs**) are the upfront rules, processes and requirements of regulation under Part 4 of the Commerce Act 1986 (the **Act**).
3. We commenced the current review of the Transpower capex IM on 28 April 2017 by issuing a notice of intention.<sup>1</sup>
4. On 15 May 2017 we published a consultation paper on our proposed focus areas for the review.<sup>2</sup> We received a number of submissions and cross submissions on our proposed focus areas consultation paper which are available on our website.<sup>3</sup>
5. Those submissions and cross submissions have informed this process update and will also inform our draft decision.

### Focus areas and key issues for the capex IM review

6. Submissions were largely supportive of the five focus areas we proposed. We consider that we can include any new issues that were raised in submissions within these five focus areas.<sup>4</sup>
7. As such, we confirm our focus areas for the review as:
  - 7.1 Focus area 1: Given the changing landscape in the energy sector, are there adjustments that could be made to the capex IM to better ensure the right

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<sup>1</sup> Commerce Commission “Notice of intention – Capex IM review” (28 April 2017).

<sup>2</sup> Commerce Commission “Proposed focus areas for the capex IM review” (15 May 2017).

<sup>3</sup> <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/transpower-input-methodologies/capex-input-methodology-review/>

<sup>4</sup> MEUG proposed that we add an extra focus area to our review, titled ‘Given the fundamental problem of information asymmetry, can engagement be improved?’. We agree that effective engagement with Transpower is a key issue for our review, and consider it to be an aspect of the proportionate scrutiny focus area. (MEUG “MEUG submission on Transpower capex input methodology review” (14 June 2017)).

transmission investments are being made, including non-transmission solutions?

- 7.2 Focus area 2: Does the capex IM support a proportionate approach to scrutiny?
  - 7.3 Focus area 3: Once expenditure has been approved, does the capex IM appropriately deal with changing circumstances?
  - 7.4 Focus area 4: Are the incentive mechanisms in the capex IM effective?
  - 7.5 Focus area 5: Are aspects of the capex IM too complex and prescriptive?
8. Following our assessment of submissions and cross submissions, we have identified a number of key issues to be considered in these focus areas as part of the capex IM review. Given that some of these issues are relevant to more than one focus area, we consider it more useful to re-group them into the following topics:
- 8.1 Topic 1: Incentive mechanisms, which is likely to include:
    - 8.1.1 considering the appropriate categorisation for different types of capex;
    - 8.1.2 whether the individual incentive mechanisms in the capex IM are appropriate;
    - 8.1.3 whether there is potential for tailoring incentive rates for different types of capex projects;
    - 8.1.4 reviewing Transpower's exposure to input prices and foreign exchange rate movements and the interaction with the incentive mechanisms; and
    - 8.1.5 whether aspects of the investment test should be extended to other types of capex not already subject to the test.

- 8.2 Topic 2: Process matters, which includes:
  - 8.2.1 potentially introducing a staged approval process (for major capex proposals (**MCPs**));
  - 8.2.2 potentially introducing an application window for MCPs; and
  - 8.2.3 potentially considering verification of Transpower's investment proposals.<sup>5</sup>
- 8.3 Topic 3: Transpower's engagement with stakeholders, which includes the extent to which Transpower:
  - 8.3.1 consults with stakeholders during project planning;
  - 8.3.2 provides estimates of the impact of an investment on transmission prices;
  - 8.3.3 consults on its demand forecasts (particularly for base capex projects); and
  - 8.3.4 provides ex-post information on projects and explains variations from what was planned and approved.
- 8.4 Topic 4: Information requirements, which includes:
  - 8.4.1 potentially requiring Transpower to more clearly explain the reasoning behind its integrated transmission plan (ITP) assumptions;
  - 8.4.2 potentially requiring Transpower to provide more narrative and explanation around its planned investment decisions; and
  - 8.4.3 identifying any 'quick wins' to simplify and improve the clarity of the information requirements in the capex IM (for base capex proposals, listed project proposals and MCPs).

### **Update on the process steps and timeline for reaching final decision**

- 9. In line with our notice of intention, we still intend to publish our draft decision in Q4 2017, and our final decision in Q1 2018. A summary of the planned process steps between now and the final decision is set out in Table 1 below.

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<sup>5</sup> For example, section 54S(2)(a) provides for the capex IM to include requirements that must be met by Transpower, including the extent of independent verification of capital expenditure proposals.

10. We are continuing to apply the framework as set out in the December 2016 IM review framework paper.<sup>6</sup> As such, we will only make changes to the capex IM where this is likely to:
- 10.1 promote the Part 4 purpose in s 52A more effectively;
  - 10.2 promote the IM purpose in s 52R more effectively (without detrimentally affecting the promotion of the s 52A purpose); or
  - 10.3 significantly reduce compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s 52A purpose).
11. Our draft decision on the capex IM review will give stakeholders an opportunity to comment on any proposed changes to the capex IM as a whole package. As such, we see the draft decision as the main consultation event in our process. Therefore, we are only proposing to add intermediate process steps where we see real benefit in doing so.
12. We have identified some additional process steps to help us reach our draft decision. These additional process steps are set out below.
13. In our May consultation paper we sought stakeholders' views on the merits of phasing the review. We suggested that, for example, we could complete our review of those aspects of the capex IM affecting the IPP for the 2020-2025 regulatory period (RCP3) in a shorter timeframe, and complete our review of all other aspects of the capex IM in a longer timeframe. We noted that any IM amendments that affect the price-quality path will generally not take effect until the next price-quality path reset (sections 53ZB and 53ZC of the Act).
14. As such, we noted it may be desirable to make any IM amendments that would affect the IPP in advance of RCP3, otherwise those changes would not take effect until RCP4. Further, because Transpower is required to submit its proposal for its IPP for RCP3 by 1 December 2018, we suggested it may be desirable to have any changes to the IMs that affect the IPP in place in advance of that date as well.
15. To date, we have not received comments to suggest that phasing will be required for this review, but we will confirm this following our consultation on our emerging views on incentive mechanisms.
16. At this stage, we do not consider that any engagement steps beyond those listed in Table 1 will be required before we will be in a position to reach final decision. However, we may add additional engagement steps if, as we continue with our review, we consider it necessary to do so. We will continue to keep stakeholders updated if our process changes.

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<sup>6</sup> Commerce Commission "Input methodologies review decisions – Framework for the IM review" (20 December 2016).



**Table 1: Planned process steps through to final decision**

Indicative process step	Indicative date
Request for further information from Transpower on potential improvements to the information requirements in the capex IM	28 July 2017 (due: 11 August 2017)
Targeted engagement with stakeholders to clarify submissions	Early August 2017
Emerging views on Topic 1: Incentive mechanisms	Early September 2017
Submissions on emerging views due	Late September 2017
Draft decision and draft determination	10 November 2017
Submissions on draft decision due	8 December 2017
Cross submissions on draft decision due	22 December 2017
Final decision	Q1 2018

**Request for information from Transpower on potential improvements to the information requirements in the capex IM**

17. In its submission on our May consultation paper, Transpower submitted that:
- 17.1 “there are opportunities to refine some of the information requirements and process interventions applying to base capex”;<sup>7</sup> and
  - 17.2 “we ... could revisit the need for some of the requirements under Schedule F5”.<sup>8</sup>
18. We invite Transpower to provide us with more detail on these submissions by 11 August 2017, including:
- 18.1 any specific information requirements it considers should be added, amended or removed;
  - 18.2 what problems the suggested changes would address; and
  - 18.3 how making the suggested change would be consistent with our framework for the capex IM review.

<sup>7</sup> Transpower “Capex IM review issues identification via focus areas” (14 June 2017) p. 4.

<sup>8</sup> Transpower “Capex IM review issues identification via focus areas” (14 June 2017) p. 5.

**Targeted engagement with stakeholders to clarify submissions**

19. During early August, we intend to follow up with some stakeholders directly to clarify points made in their submissions or cross-submission.

**Emerging views on Topic 1: Incentive mechanisms**

20. Submissions on our proposed focus areas considered that the incentives on Transpower will be an important part of this review.<sup>9</sup> We consider it will be beneficial to present our emerging views on the appropriate incentive mechanisms that should apply to Transpower under the capex IM in a paper, and invite comments from stakeholders before reaching our draft decision. At this stage we do not propose to publish emerging views on the other topics.
21. We intend to publish the emerging views paper on incentive mechanisms by early September 2017 and anticipate seeking submissions by the end of that month.

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<sup>9</sup> ENA “Transpower capex IM review” (14 June 2017); Meridian “Areas of focus for the Transpower capex input methodology review” (14 June 2017) p. 1; MEUG “MEUG submission on Transpower capex input methodology review” (14 June 2017) para 16; Transpower “Capex IM review issue identification via focus areas” (14 June 2017) p. 4.