



USERS' PERSPECTIVE

Capex IM Introductory Workshop



24 MAY 2017

POWERING NEW ZEALAND TODAY + TOMORROW

INTRODUCTION

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OUTLINE

- Transpower Context
- Incentives
- Response to the Capex IM
- Summary

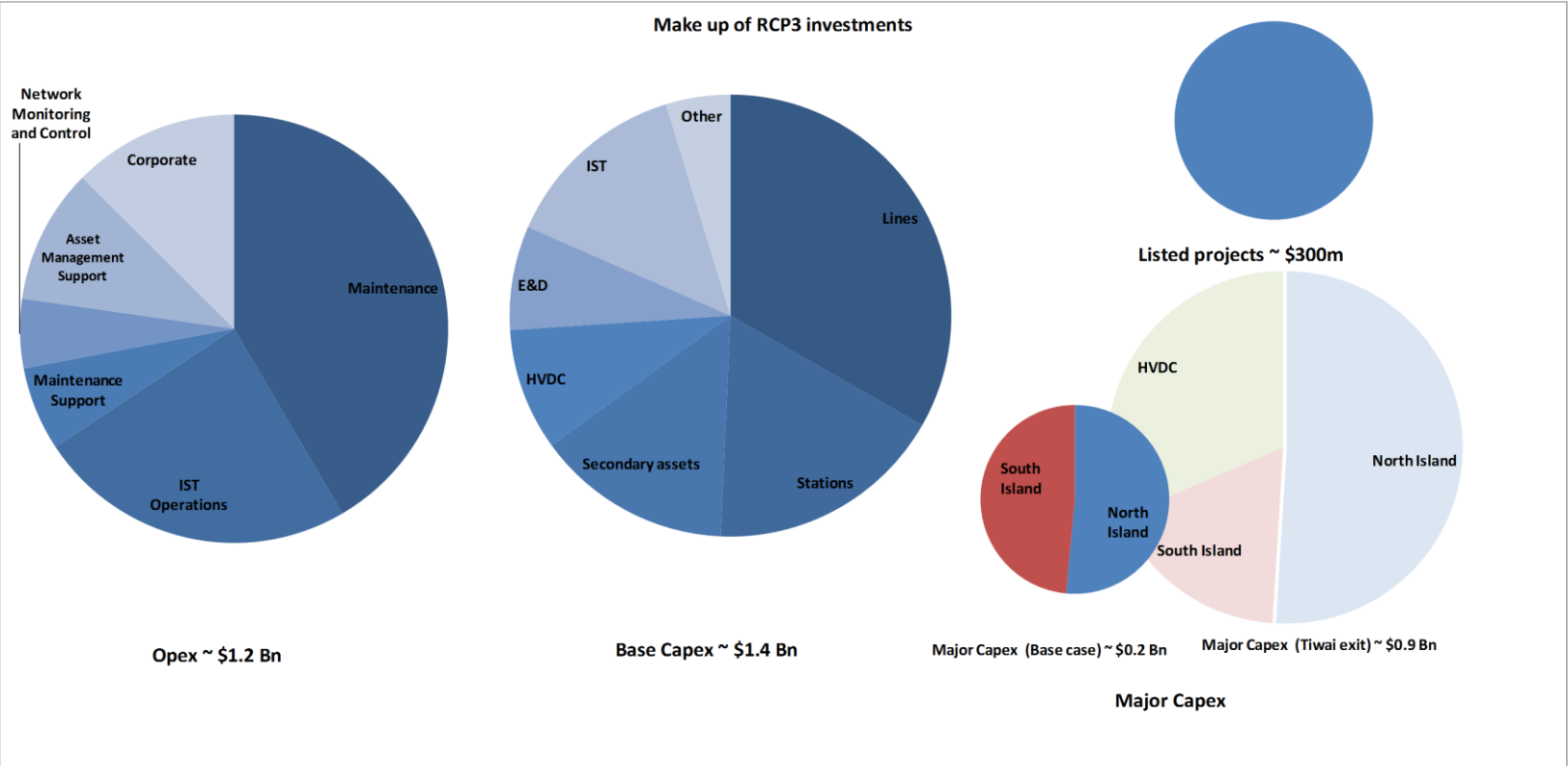


TRANSPower CONTEXT

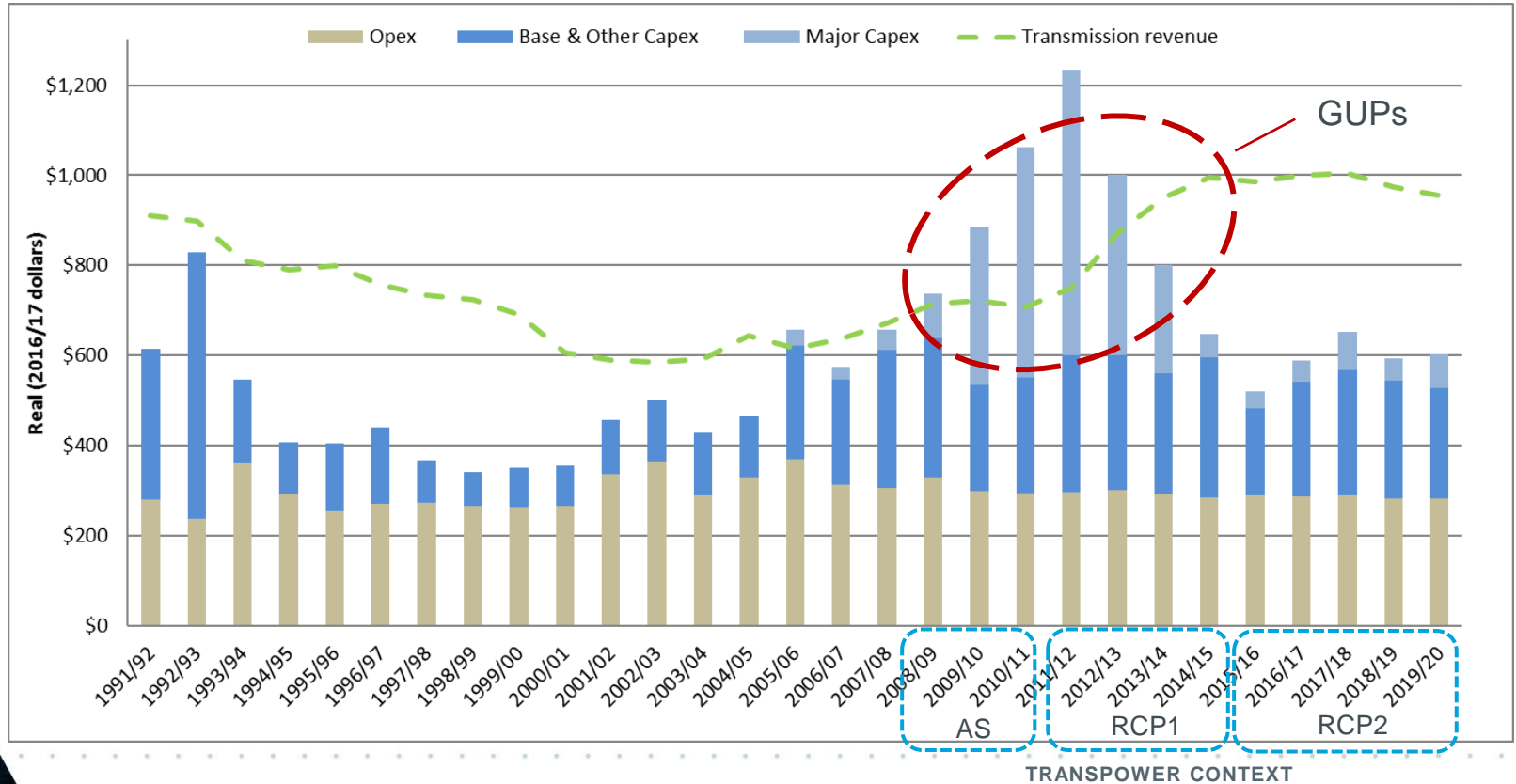
- Our Business
- RCP3 Outlook
- Journey to Here
- Strategic Context



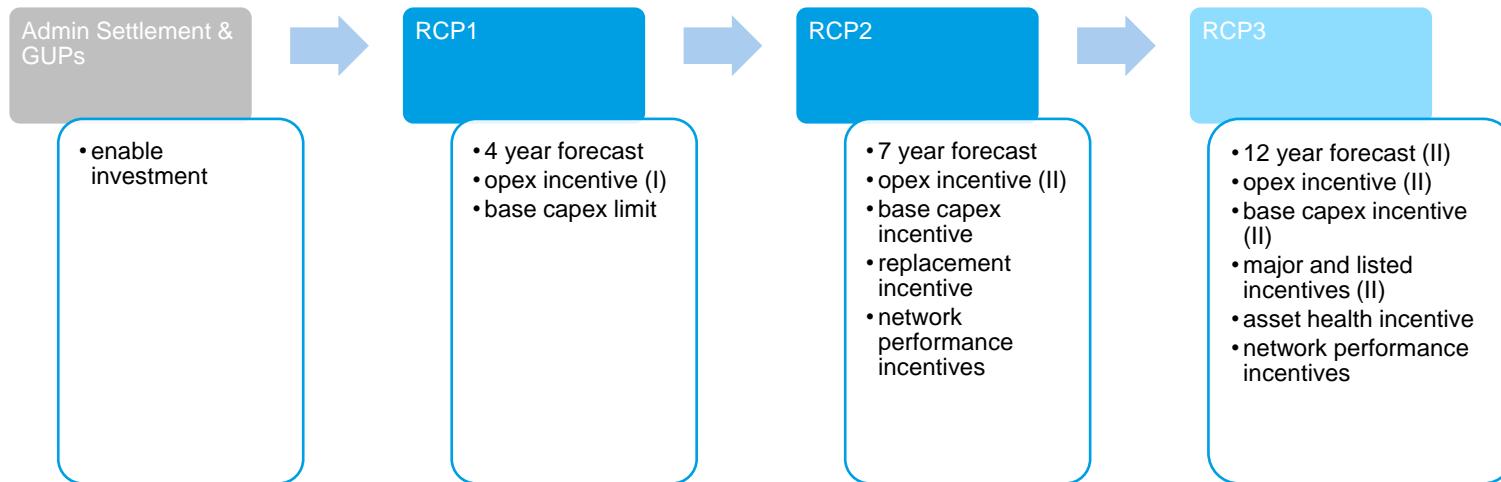
RCP3 OUTLOOK



JOURNEY TO HERE

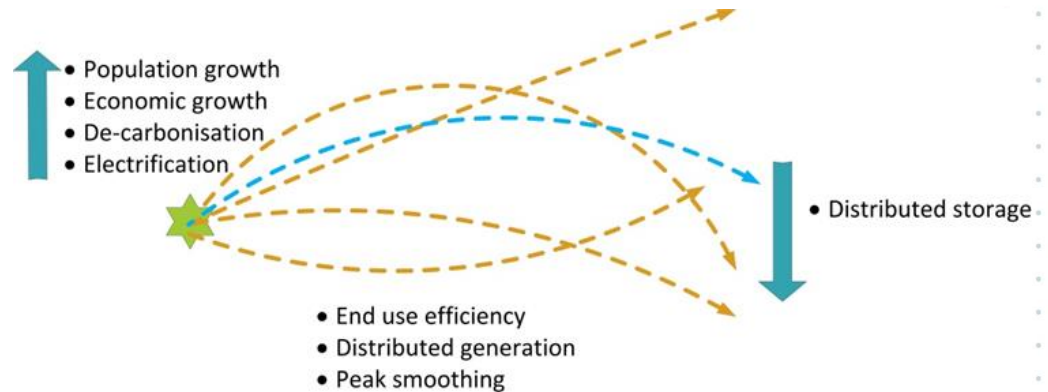


JOURNEY TO HERE (2)



STRATEGIC CONTEXT

- Changing landscape – need for flexibility, agility, innovation
- Bright long-term future for the grid
- Near-term uncertainty
- Mid-term challenge to manage growth pressures
- Longer-term transformative shift



TRANSPOWER CONTEXT

INCENTIVES

- Regulatory Objectives
- Efficiency
- Role of Incentives
- Incentive Design



REGULATORY OBJECTIVES

- Harness power of incentives to drive efficiency:
 - 1500+ people working at it continuously using the best available information
- Focus on outputs and outcomes, not inputs and processes
 - focus on what matters
 - provide flexibility to innovate and act on best information

EFFICIENCY

Three kinds of efficiency:

- delivering work cost efficiently
- doing the right work (optimising lifecycle costs)
- doing the right work (optimising the network)

The first one requires a steady, mature delivery system (in Transpower and wider).

The second and third require flexibility and a good understanding of risk.

They all require time.

ROLE OF INCENTIVES

Three kinds of incentives:

- financial penalty/reward
- wider regulatory (incl. RCP cycle, depreciation settings):
 - repeat game, long-term commitment
 - credible, constructive player
- strategic:
 - sustain power system value proposition, while preserving social licence to operate

Penalties and rewards are 'in the mix'. They can support and reinforce good management.
Consistency and stability more important than precision.

INCENTIVE DESIGN (1)

Type	Comments
Opex	Longest running, though new design only just approved. Complex, but seems to work.
Base Capex	Brand new. Discontinuity between RCP1 and RCP2. Successfully supports 'totex' thinking. Rough edges can be fixed for RCP3.
Outputs – network performance (lagging measures)	Brand new. Good first step. Influencing operations. Metrics will mature, impact on capex will mature.
Outputs – volume targets (leading measures)	Incentivising fixed plan in RCP2, not optimal outputs. Move to asset health in RCP3 and, potentially, network risk in RCP4.

INCENTIVE DESIGN (2)

Type	Comments
Major capex	Room for improvement. Efficiency adjustment does not work. Outputs not well specified. Agility challenges. <i>Ex post</i> efficiency assessment very challenging.
Listed projects	Unresolved challenge.
Totex	Base capex and opex incentives near enough to balanced. No impediment to non-traditional solutions (e.g. demand response).

TRANSPower RESPONSE TO THE CAPEX IM

- Planning & Delivery
- Allocating Funds
- Processes



TRANSPower RESPONSE

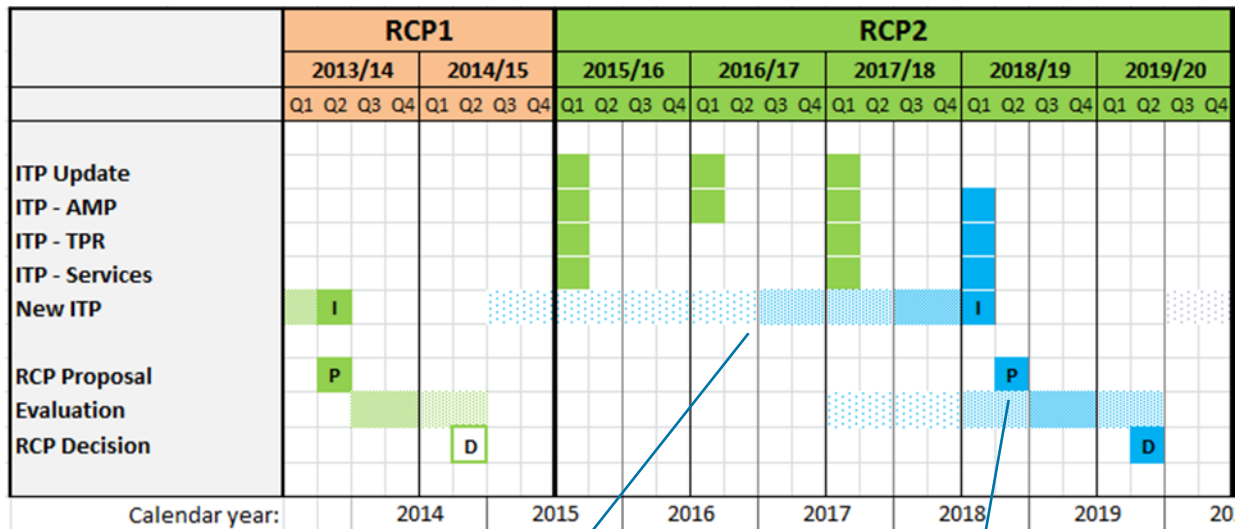
PLANNING & DELIVERY (1)

- Reinforcing drivers to extend planning horizons, enhance asset management
- Over-extended plan detail first time, approach maturing for RCP3
- RCPs have become a key part of the landscape
- Transition to base capex incentive disruptive
- Commissioning basis for incentives adds complexity and instability

- Reinforcing drivers to improve delivery pipeline

- Regulatory approval a key step for MCPs and listed projects
- Reinforces drivers to consult, find best solutions
- Can complicate timing and commitment

PLANNING & DELIVERY (2)



Planning for next RCP >3 years ahead

Proposal 18 months ahead of RCP

ALLOCATING FUNDS

- Reinforcing drive to allocate funds to highest need
 - base capex incentive is key
 - 'allowance' term and volume targets unhelpful
- Good RCP2 examples:
 - refurbishing transformers (opex) to extend life (reduce capex)
 - network development (E&D) capex reallocated to higher need areas
 - CUWLP on hold
- Reset uncertainty is a challenge – infrequent, so will take time to mature

PROCESSES

- RCP cycle reinforces asset management journey
- Challenge (for everyone) to separate regulatory obligations from how we've chosen to respond
 - perception of regulatory requirements sometimes worse than reality
 - no single person works with the full Capex IM
- Major capex investment test relatively prescriptive (inputs and methodology)
 - origins go back 10+ years
 - could be modernised for investment challenges of today (and tomorrow!)

SUMMARY

- Capex IM reinforcing positive outcomes
- regulation maturing alongside business
- flexibility and agility increasingly important

