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John McLaren
Manager, Regulation Branch
Commerce Commission

By email: regulation.branch@comcom.govt.nz

Dear John

Proposed implementation to Incremental Rolling Incentive Scheme

Thank you for the opportunity to comment on the Commission's *proposal to implement amendments to input methodologies for electricity lines businesses (IRIS)* published 20th October.

The comments in this submission relate to the Commission's Transpower - specific proposal under this consultation. No part of our submission is confidential.

Symmetric IRIS decision

The significant policy decision under this implementation consultation is that for Transpower the operating expenditure incentive scheme (IRIS) is to be made symmetrical for RCP2, in contrast to the operating efficiency incentives in play for RCP1. Our submission to the proposal¹ identified that the proposed symmetric IRIS coupled with an imposed productivity adjustment at the time of the control period reset risked undermining the intended operation of the IRIS. While we note the Commission's decision to adopt a symmetrical IRIS for Transpower we remain of the view that further clarification is needed in relation to the role of and interaction between the opex reset and IRIS.

We previously submitted that if a symmetrical IRIS was to be adopted then further attention needed to be given to address deficiencies in the drafting. We had identified two issues.

1. The drafting was retrospective, in that it applied not just to the RCP2 'allowance vs. spend' results (and hence revenues in RCP3), but also to the RCP1 results, and therefore revenues in RCP2.
2. Fundamental methodological issues with the new calculation – whether from errors in the calculations or invalid assumptions – that produce significant variations in the *sharing ratio* and which would result in material and undesirable, or even perverse, outcomes.

¹ Available at <http://www.comcom.govt.nz/regulated-industries/electricity/electricity-transmission/transpower-individual-price-quality-regulation/transpowers-price-quality-path-from-2015-to-2020/>

Remedying flawed drafting

With respect to the first issue, the Commission has clarified in this consultation that the new IRIS provisions are intended to apply from the 2015/16 year (first RCP2 year) for calculating IRIS carry forward amounts and from 2020/2021 year (first RCP3 year) for generating recoverable cost amounts (via a new construct of an 'opex incentive amount'). The role of the transitional provisions is to allow for IRIS amounts under current policy for RCP1 to be appropriately recognised as recoverable costs in RCP2. We agree with the use of the transitional (grandfathered) provisions to retain the IRIS credits derived from current policy settings. We have suggested in the appendix drafting changes to the amendments section under 5.2 in the consultation paper to ensure that the correct reading of a regulatory period as RCP1 or RCP2.

For the second methodological issue, we appreciate that the Commission has acknowledged a problem exists but note that the combination of lack of resource and drafting complexity has created a risk that the input methodology is not ready for RCP2. While technically the policy will not affect the price path until RCP3 the incentives operate throughout the RCP2 period and are relevant factors in our planning for that period. If the revised IRIS policy is to have effect during RCP2 then at a minimum the IM should be in place at the start of that period, but it would be more satisfactory if the IM were set well in advance of the RCP.

No ground for adopting defective drafting into the IM

Until the new final drafting for the changed IRIS policy is available there is no rationale for changing the current IM from the current policy and the Commission should refrain from doing so, otherwise it appears that Commission proposes to knowingly incorporate flawed drafting into the IMs. We find this a strange proposition that we cannot support. That is because it is an unnecessary administrative step that creates risk for Transpower (IMs are notoriously difficult to change, even where there are good grounds) and reduces the certainty provided IM framework.

We further submit that, until the drafting for implementation of the new policy is certain, that the transitional provisions need to cater for the eventuality that the symmetric IRIS policy is not practically implementable.

Please let me know if you have any questions or would like to discuss any of the points made in this submission.

Yours sincerely

A handwritten signature in black ink, appearing to be 'JC' followed by a long horizontal stroke.

Jeremy Cain
Regulatory Affairs Manager



Appendix – Suggested drafting for amendment’s section 5.2

5.2 In the **Transpower IM Determination**:

- (a) add the following definition in alphabetical order to clause 1.1.4(2):

RCP2 means the **regulatory period** commencing on 1 April 2015 and ending on 31 March 2020;
- (b) replace “clause 3.6.1(5)” in the definition of ‘inflation rate’ in clause 1.1.4(2) with “clause 3.6.6(5)”;
- (c) replace “clause 3.6.1(4)” in the definition of ‘incremental adjustment term’ in clause 1.1.4(2) with “clause 3.6.6(4)”;
- (d) renumber clauses 3.6.1 to 3.6.3 as clauses 3.6.6 and 3.6.8 respectively and include under the heading ‘**SECTION 3 Transitional provisions**’;
- (e) replace “an **opening year**” in renumbered clause 3.6.6(1) with “the **opening year** of **RCP1**”;
- (f) replace “the **regulatory period**” in renumbered clauses 3.6.6(2), 3.6.6(3) and 3.6.8(b) with “**RCP1**”;
- (g) replace “every **regulatory period** except **RCP1**” in renumbered clause 3.6.6(4)(a) with “**RCP2**”;
- (h) replace “the preceding **regulatory period**” in the definitions of the variables t-1 and t-2 in renumbered clause 3.6.6(4) with “**RCP1**”;
- (i) replace “a preceding **regulatory period**” in renumbered clause 3.6.7(2)(a) with “**RCP1**”; and
- (j) make consequential amendments to other clause number references in relation to the above matters.