

Notice to supply information to the Commerce Commission under section 53ZD of the Commerce Act 1986

To: Transpower New Zealand Limited
PO Box 1021
WELLINGTON

1. The Commerce Commission (Commission) requires Transpower New Zealand Limited (Transpower) to provide it with the information specified in this notice, issued under s 53ZD of the Commerce Act 1986 (the Act). We need this information for the purpose of carrying out our functions and exercising our powers under Part 4 of the Act. Specifically, this information is required for the purpose of setting Transpower's operating and capital expenditures used to determine Transpower's revenue forecasts for the period 1 April 2015 to 31 March 2020, as well as the quality standards that will apply for that period.

Interpretation

2. In this notice, unless the context otherwise requires, bolded terms have the meaning as set out below and other terms have the meaning as defined in the **Capex IM**:

base capex categories has the same meaning as set out in the **Capex IM**, which include the categories used to define **identified programmes** for **RCP2** that have been agreed to by the Commission and **Transpower** under clause 2.2.1(1) of the **Capex IM** or any other categories as agreed by the Commission;

business improvement initiative means those initiatives identified in chapter 4 of **Transpower's RCP1 proposal**, published in February 2011 and summarised by **Transpower** in its Business Improvement Initiatives document, March 2012;

capex means **capital expenditure**;

Capex IM means Re Transpower Capital Expenditure Input Methodology Determination [2012] NZCC 2;

forecast MAR has the same meaning as set out in the **IPP determination**;

Geoff Brown consulting report means Geoff Brown & Associates Ltd, Review of **Transpower's** Forecast Operating and Capital Expenditure for 2012-15 prepared for Commerce Commission, Final, 15 June 2011;

HVDC means high voltage direct current;

identified programme means **base capex categories** or **opex portfolios** for which expenditure is forecast to be undertaken during **RCP2** and which are included in one or more of the following:

- a. Criterion 1 - replacement and refurbishment:
 - (i) the six largest replacement and refurbishment **base capex categories** (including related **grid opex** maintenance project portfolios) by forecast **base capex** spend for **RCP2**; or
 - (ii) where the six **base capex categories** in paragraph (i) do not provide 70% coverage of forecast replacement and refurbishment **base capex** spend for **RCP2**, the number of replacement and refurbishment **base capex categories** (including related **grid opex** maintenance project portfolios) that are required to provide 70% coverage ranked from largest to smallest by forecast **base capex** spend for **RCP2**; and
 - (iii) any replacement and refurbishment **base capex categories** (including related **opex portfolios**) with a total increase in forecast spend for **RCP2** of \$10 million in 2012/13 prices over and above the forecast spend (adjusted for inflation and multiplied by 1.2) for the equivalent categories in **RCP1**;
- b. Criterion 2- enhancement and development:
 - (i) the eight largest enhancement and development **base capex categories** by forecast **base capex** spend for **RCP2**;
- c. Criterion 3 - information systems and technology:
 - (i) the four largest information systems and technology portfolios (across all **base capex categories** and **opex portfolios**) by forecast spend for **RCP2**; or
 - (ii) where the four portfolios in paragraph (i) do not provide 70% coverage of combined forecast **base capex** and **opex** spend related to information systems and technology for **RCP2**, the number of information systems and technology portfolios (across all **base capex categories** and **opex portfolios**) that are required to provide 70% coverage ranked from largest to smallest by forecast spend for **RCP2**;
- d. Criterion 4 - **grid opex**:
 - (i) the four largest **grid opex portfolios** across **grid opex** maintenance **projects** and **grid opex** routine maintenance, excluding **grid opex** maintenance project portfolios included under Criterion 1 in paragraph a; or
 - (ii) where the four **grid opex portfolios** together with the **grid opex** maintenance **projects** portfolios included under Criterion 1 in paragraph a do not provide 70% coverage of forecast **grid opex** spend

for **RCP2**, the number of **grid opex portfolios** that are required to provide 70% coverage ranked from largest to smallest by forecast **grid opex** spend for **RCP2**;

IPP determination means the Individual price-quality determination applicable to **Transpower** pursuant to Part 4 of the Commerce Act 1986 dated 22 December 2010 reflecting all amendments as of 31 October 2012, determined by the Commission under s 52P of the Act;

key assumption means an assumption made by **Transpower** of significance to the forecast of **opex**;

non-grid means **opex** relating to assets or services conducted by **Transpower** other than those relating to the **grid**;

obligation means a legally enforceable duty owed by **Transpower**, whether arising under legislation, in tort or in contract;

operating expenditure allowance means monetary amount of **opex** to be used when calculating maximum allowable revenue or forecast maximum allowable revenue in applying an **IPP determination**;

opex means **operating expenditure**;

opex portfolios are the cost categories used for **opex** as part of **Transpower's RCP1 proposal** onto **opex portfolios** or other portfolios along with mappings of these portfolios onto **RCP1 opex portfolios** agreed to by the Commission on or before 30 September 2013.

planning standards means **policies** adopted by **Transpower** which relate to the planning of the **grid** and the forecasting of **capex** and **opex** for that purpose, including in relation to:

- a. long term **grid** development;
- b. **grid** maintenance; and
- c. **grid** operations;

quality measure means each of the quality measures specified by the Commission in clause 4.1(1) of the **IPP determination**;

quality target means each of the quality targets specified by the Commission in clause 4.2 of the **IPP determination**;

RCP1 final reasons paper means the **Transpower** Minor Capex and Opex Allowances, and Quality Standards for RCP1 Final Decisions dated August 2011 made by the Commission to determine **operating expenditure allowances**, minor capex allowances, and targets, **caps** and **collars** applying to quality standards for the **remainder period** of **RCP1**;

RCP1 proposal means Expenditure Forecasts and Quality Performance: 1 July 2012 to 30 June 2015, submitted by **Transpower** in February 2011;

RCP2 means the period commencing on 1 April 2015 and ending on 31 March 2020;

report on outputs and performance objectives means the information required under clause E6 of the **Capex IM**; and

Transpower IM Determination means **Transpower** Input Methodologies Determination [2012] NZCC 17, issued by the Commission on 29 June 2012.

Information requirements

General information

3. Please provide a summary **document** that maps the information provided by **Transpower** in response to the requirements set out in this notice.
4. Please provide the following documentation concerning **Transpower's** company structure and its regulated services:
 - 4.1 a complete company structure map, including all parent companies and subsidiaries, as well as a high-level description of the main functions of each and their relationship with **Transpower**.
 - 4.2 a complete organisation chart, including a description of the departments, the main organisational functions and their relationships, and staff numbers.
 - 4.3 a description of any proposed material changes to regulated services or outputs provided in **RCP1** to be made in **RCP2**.

RCP1 opex

5. Please provide the following information concerning **opex** for **RCP1**:
 - 5.1 a description of the key drivers of **opex**; and
 - 5.2 in relation to **RCP1 opex**, evidence demonstrating if, and how, **Transpower** has:
 - 5.2.1 pursued and is pursuing process improvements, including those identified as a **business improvement initiative**;
 - 5.2.2 ensured and is seeking to ensure appropriate least-whole-of-life cost and efficient interventions;
 - 5.2.3 pursued and is pursuing cost reduction strategies for each of its **opex portfolios**; and

- 5.2.4 ensured and is seeking to ensure that both internal and external suppliers of goods and services have incentives to perform well and identify cost savings.

RCP2 opex

6. Please provide the following information concerning **opex** for **RCP2**:
- 6.1 a description of **Transpower's** objectives for its **opex** and the ways in which the **opex proposal** reflects the efficient costs that a prudent network operator would require to:
- 6.1.1 meet or manage the expected demand for **electricity transmission services**, and deliver proposed quality standards and **grid outputs**, during **RCP2** and over the longer term; and
- 6.1.2 comply with applicable regulatory **obligations** of those services;
- 6.2 a summary of how **Transpower** has set objectives for its **opex**, and key information that has been relied on to set these objectives;
- 6.3 an overview of the methods used to develop the **opex** forecast for each of its **opex portfolios** and for **opex portfolios** in aggregate. This must include details of:
- 6.3.1 the forecasting approach that was used, eg, bottom up, trend, benchmarking analysis;
- 6.3.2 how uncertainties were incorporated into forecasts;
- 6.3.3 how synergies with other **opex portfolios** and **capex** have been taken into account;
- 6.3.4 what business unit was responsible for developing the forecast;
- 6.3.5 the challenge and approval process employed for sign-off of forecasts;
- 6.3.6 the differences, if any, and improvements in the forecasting approach used to develop forecasts compared to that used for the **RCP1 proposal**;
- 6.3.7 ways in which **Transpower** has addressed concerns with its **RCP1 proposal** that were identified:
- (a) in the **RCP1 final reasons paper**;
- (b) in the **Geoff Brown consulting report**; and
- (c) by **Transpower** when developing its **business improvement initiatives**;

- 6.4 a description of any efficiency assumptions that have been made in the **opex proposal**;
- 6.5 a description of any contingencies that are included in the **opex proposal**, and the methodology for calculating those contingencies;
- 6.6 an overview that gives context to, and explains:
 - 6.6.1 any linkages between **Transpower's** historical **opex**, quality performance and **capex**, and **Transpower's** forecast **opex**, proposed quality standards and **grid outputs** and **capex** for **RCP2**;
 - 6.6.2 how **Transpower** is working to achieve the objectives it has set for its **opex**; and
 - 6.6.3 any factors driving a material change in levels of **opex** for each of the **opex portfolios** forecast for **RCP1** and forecast for **RCP2**;
- 6.7 an explanation of how the **opex proposal** is consistent with:
 - 6.7.1 the **integrated transmission plan** for **RCP2**, including the **report on outputs and performance objectives**;
 - 6.7.2 the **base capex proposal** for **RCP2**; and
 - 6.7.3 **Transpower's RCP1 proposal**;
 and if not, why;
- 6.8 an explanation of the overall deliverability of proposed levels of **opex** for each of the **opex portfolios**, as well as any factors likely to affect this, including:
 - 6.8.1 a description of plans for resourcing and delivering proposed levels of **opex** for each of the **opex portfolios**;
 - 6.8.2 identification of the key risks associated with resourcing and delivering proposed levels of **opex** for each of the **opex portfolios**, including explanation of each risk's potential to affect;
 - (a) forecast levels of **opex**;
 - (b) forecast **grid outputs**; and
 - 6.8.3 a description of the processes that will be implemented to manage or mitigate these key risks; and
- 6.9 In respect of **opex** included in information submitted in response to paragraphs 15 to 18, a description of the rationale for any forecast expenditure for any one of the **opex portfolios** not deemed to be an **identified programme**.

Policies, processes and consultants' reports

7. Please provide the following information in relation to **policies**, processes and consultants' reports:
 - 7.1 a schedule listing and describing all **policies** and processes applicable to **opex** concerning:
 - 7.1.1 **opex portfolios**;
 - 7.1.2 asset management, including ensuring lowest lifecycle costs for assets;
 - 7.1.3 business planning;
 - 7.1.4 **grid outputs**;
 - 7.1.5 insurance (including self insurance);
 - 7.1.6 procurement related to the **opex proposal**;
 - 7.1.7 monitoring and reporting on predicted versus actual performance (including efficiency gains) achieved for **portfolios**;
 - 7.1.8 programs and initiatives that have been the subject of **Transpower's** internal approval system;
 - 7.1.9 capital works, including the demarcation between **capex** and **opex**, the trade-off between **capex** and **opex** and the decision processes for investing in **capex** or **opex**; and
 - 7.1.10 any other **policies** relevant to the **opex proposal**;
 - 7.2 a description of:
 - 7.2.1 all material changes to **policies** and processes applicable to **opex** that **Transpower** has made since the **RCP1 final reasons paper** was published; and
 - 7.2.2 the impacts of these changes on forecast levels of **opex** for each of the **opex portfolios**;
 - 7.3 a schedule that lists all engagements with consultants **Transpower** has sought specialist industry opinion as part of the business planning process from, when those engagements occurred, and a summary of:
 - 7.3.1 all final and draft reports, including recommendations; and
 - 7.3.2 all other written advice and recommendations received from the consultants, excluding any non-substantive emails (such as those concerning process matters), as a result of these engagements.

Procurement

8. **Transpower** may outsource, or plan to outsource, matters relevant to the **opex proposal**, eg, contracting for the provision of maintenance services. Please provide details of arrangements with service providers for this outsourcing. These details must enable an assessment of how **Transpower's opex** and proposed quality standards and **grid outputs** will be met by the service provider, and must include but not be limited to;
 - 8.1 the size, experience, and capability of the service provider;
 - 8.2 the value proposition for outsourcing;
 - 8.3 the process used to select, evaluate and award outsourced work;
 - 8.4 any performance targets and monitoring arrangements established; and
 - 8.5 any other relevant matters relating to the service provider and arrangements considered when outsourcing.

Identified programmes

9. Please provide the following information for each of **Transpower's opex portfolios** deemed to be an **identified programme**:
 - 9.1 a description of the **identified programme**, including its aims and objectives;
 - 9.2 the cost-benefit analyses that support it;
 - 9.3 an explanation as to its deliverability, with reference to factors likely to specifically affect that **programme**;
 - 9.4 a description of the methodology used to generate the forecast of its **opex**, including, but not limited to-
 - 9.4.1 the **key assumptions** and how they were applied;
 - 9.4.2 any relevant cost benchmarking undertaken by or for **Transpower**;
 - 9.4.3 any information available on internal historical cost trends for specific cost components relied upon, eg, unit costs;
 - 9.4.4 any contingency included in proposed costs; and
 - 9.4.5 the methodology for calculating such contingencies.
 - 9.5 a list of all relevant **documents** taken into account in forecasting **opex** for that **programme**, including **documents** relating to the deliverability of that **programme**, relevant **policies** and consultant reports;

- 9.6 an explanation of the extent to which forecast **opex** for that **programme** implements the **key assumptions**, recommendations from any consultant reports, and **policies** relating to the planning of the **grid** and the forecasting of **capex** and **opex** for that purpose, including in relation to-
 - 9.6.1 long term **grid** development;
 - 9.6.2 **grid** maintenance; and
 - 9.6.3 **grid** operation;
- 9.7 an explanation of the extent to which forecast **non-grid opex** for that **programme** implements the **key assumptions**, recommendations from any consultant reports, and **policies** relating to the other aims and objectives of **Transpower**;
- 9.8 an explanation of all material departures from any-
 - 9.8.1 relevant **policies**;
 - 9.8.2 **planning standards**; or
 - 9.8.3 conclusions and recommendations contained in the consultant reports identified above;
- 9.9 an overview of any significant tradeoffs between **opex**, **base capex**, **major capex** and quality that **Transpower** considered in the development of that **programme**;
- 9.10 an assessment of that **programme's** impact upon either or both of the-
 - 9.10.1 quality performance; and
 - 9.10.2 serviceability,
 of the assets to which it relates;
- 9.11 a description of relevant regulatory **obligations** that have a material effect on that **programme**;
- 9.12 an explanation of any material step change from historical costs in any cost component for the same or a similar type of **programme**, and an explanation of the effect of the step change on forecast **opex** for that **programme**; and
- 9.13 a schedule of any models used, accompanied by explanations of the models and how they were relied upon.
- 9.14 in relation to the procurement of any outsourced services which have a material effect on that **programme**:

- 9.14.1 identify each of the outsourced services;
- 9.14.2 explain the nature of engagement under which the outsourced services are to be provided, eg, a discrete contract or broader operational arrangement;
- 9.14.3 provide an overview of the procurement process, including an explanation of the extent to which the process was competitive, and if not, why not;
- 9.14.4 identify any significant components of any outsourced services that will be or have been sub-contracted to another supplier; and
- 9.14.5 identify any relevant procurement **documents** in a schedule, including but not limited to requests for tender and submissions in response.

Escalation factors and foreign exchange assumptions

- 10. Please provide the following information in respect of each escalation factor relied on to account for changes in input prices used in responding to this notice:
 - 10.1 a description of each escalation factor and the rationale for its use;
 - 10.2 the methodology underlying the calculation of the escalation factor's quantum, by reference to data sources, data conversions and assumptions relied upon, including lags;
 - 10.3 the weighting given to the escalation factor and description of how that weighting was determined, including any assumptions relied upon;
 - 10.4 confirmation of whether the same escalation factor has been used in the **base capex proposal**, and if not, an explanation and supporting evidence as to why different escalator factors were applied;
 - 10.5 for escalation factors that relate to labour or material inputs, an explanation of whether additional contingency factors were applied and, if so, a description of the uncertainties that the contingency factors account for and how the contingency factors were calculated; and
 - 10.6 an operational copy of the model used to generate outputs required for the **RCP2** proposal, eg, forecast **opex** for each of the **opex portfolios** for all **disclosure years** in **RCP2**.
- 11. In respect of the foreign exchange assumptions used in responding to this notice, please provide the following information:
 - 11.1 a list of the foreign exchange rates, and the source of those rates, used to prepare the **opex proposal**; and

- 11.2 an estimate of the exposure to foreign exchange movements for each foreign currency for each year of **RCP2** and a description of how these estimates were produced.
- 12. Please provide an estimate of instantaneous reserve event charges for each year of **RCP2**, and the methodology to develop these estimates.

Insurance

- 13. Please provide the following information in relation to any proposed self insurance or external insurance allowance:
 - 13.1 a description of the uncertainties covered by the allowance;
 - 13.2 an explanation of why compensation should apply for these uncertainties;
 - 13.3 an explanation of how and whether the uncertainty for which self insurance is being sought is not recovered through external insurance or any other mechanism;
 - 13.4 the methodology used to calculate the self-insurance risk premium;
 - 13.5 a report on the calculation of each self-insurance risk premium from an actuary who is qualified to provide such advice; and
 - 13.6 any quotes obtained from external insurers; and
 - 13.7 where insurance is available from an external insurer(s) and an insurance quote has been obtained:
 - 13.7.1 the amount insured for which the quote related;
 - 13.7.2 the annual amount of the premium so obtained;
 - 13.7.3 the size of the deductible;
 - 13.7.4 the terms and conditions of the insurance; and
 - 13.7.5 where **Transpower** has proposed self insurance, an explanation of why external insurance is not considered suitable.

Cost allocation

- 14. Please provide the following information in relation to the allocation of **Transpower's** costs:
 - 14.1 a description of and relevant policy **documents** relating to the cost allocation methodology, which must be consistent with clause 3.2.1 of the Transpower IM Determination, used for allocating **opex** between **electricity transmission services**, other regulated services, and unregulated services that are planned to be undertaken in **RCP2**;

- 14.2 a description of any difference between the cost allocation methodology used in respect of **RCP2** and the methodology used for the **RCP1 proposal** and the reasons for the differences; and
- 14.3 the variances, if any, between the **opex** values allocated using the methodology used for the **RCP1 proposal** and the **opex** values allocated pursuant to the methodology used for **RCP2**, and the reason for each variance.

Quantitative information

- 15. Please provide the following quantitative information:
 - 15.1 a mapping of the cost categories used for **opex** as part of **Transpower's RCP1 proposal** onto **opex portfolios** and a list of all **opex portfolios** deemed to be **identified programmes**;
 - 15.2 actual **opex** for each of the **opex portfolios** for each **disclosure year** from 2009/10 until the end of **RCP1**, where actual **opex** is available;
 - 15.3 forecast **opex** for each of the **opex portfolios** for all **disclosure years** from 2009/10 until the end of **RCP2**, where actual **opex** is not available;
 - 15.4 actual and forecast **opex** for each of the **opex portfolios** submitted as part of the **RCP1 proposal** for each **disclosure year** from 2009/10 until 2014/15 and
 - 15.5 an explanation of any variances between the **opex** values provided for the same **opex portfolios** and **disclosure year** under paragraph 15.4 and under paragraph 15.2 or 15.3, where these variances are greater than or equal to:
 - 15.5.1 10% of annual forecast **opex** for the relevant **opex portfolios** and **disclosure year**; or
 - 15.5.2 a forecast annual **opex** spend of \$750,000 in 2012/13 prices for the relevant **opex portfolios** and **disclosure year**.

Forecast MAR

- 16. Please provide a schedule listing estimated **forecast MAR** for each **disclosure year** in **RCP2** calculated in accordance with the building blocks set out in Schedule D of the **IPP determination** and the **opex proposal** and **base capex proposal**.

Efficiency improvements

- 17. Please provide the following information in relation to efficiency improvements:
 - 17.1 all efficiency assumptions relied upon in the **opex proposal**, including but not limited to the **business improvement initiatives**, for each of the **opex portfolios**;

- 17.2 for each efficiency assumption identified in paragraph 17.1, actual efficiency savings achieved for each **opex portfolio** and **disclosure year** from 2009/10 until the end of **RCP2** where actual **opex** is available; and
- 17.3 for each efficiency assumption identified in paragraph 17.1, forecast efficiency savings for each **opex portfolio** and **disclosure year** from 2009/10 until the end of **RCP2** for all **disclosure years** where actual **opex** is not available;
- 17.4 for each efficiency assumption identified in **Transpower's RCP1 proposal**, actual and forecast efficiency savings for each of the **opex portfolios** submitted as part of that proposal for each **disclosure year** from 2009/10 to 2014/15; and
- 17.5 an explanation of any variances between figures provided for the same efficiency assumption and **disclosure year** under paragraph 17.4 and under paragraph 17.2 or 17.3 where these are greater than or equal to:
 - 17.5.1 10% of annual forecast **opex** for the relevant **opex portfolios** and **disclosure year**; or
 - 17.5.2 a forecast annual **opex** spend of \$750,000 in 2012/13 prices for the relevant **opex portfolios** and **disclosure year**.

Quality

- 18. Please provide the following information in relation to **quality measures**:
 - 18.1 the actual performance for each **quality measure** and **disclosure year** from 2009/10 until the end of **RCP1**, where actual performance information is available;
 - 18.2 the forecast performance for each **quality measure** and **disclosure year** for all **disclosure years** from 2009/10 until then end of **RCP2**, where actual performance information is not available;
 - 18.3 the variance between each actual performance figure for each **quality measure** provided under paragraph 18.1 and forecast performance figures for each **quality measure** submitted as part of **Transpower's RCP1 proposal**;
 - 18.4 the variance between each forecast performance figure for each **quality measure** provided under paragraph 18.2 and forecast performance figures for each **quality measure** submitted as part of **Transpower's RCP1 proposal**;
 - 18.5 in relation to variances in **quality measures** provided under paragraphs 18.3 and 18.4:
 - 18.5.1 an explanation of the reason for each variance;

- 18.5.2 an explanation of any forecast failure to meet **quality targets** in any **disclosure year**;
- 18.5.3 a calculation of the impact that **Transpower's** forecast performance would have on **Transpower's forecast MAR** under the quality incentive scheme outlined in clause 5.6(2)(b) of the **IPP determination**;
- 18.5.4 an explanation of any actions taken, being taken or proposed to be taken to meet or better forecast performance for each **quality measure** for **RCP2**; and
- 18.5.5 any further explanation required to explain remedial action taken to mitigate the failure to meet the **quality targets** for **RCP1**.

Supporting information

Cover letter

- 19. The information required by this notice must be provided under cover of a letter on **Transpower's** company letterhead, signed by a person with the appropriate authority.

Certification

- 20. In relation to all information provided in accordance with this notice, 2 directors of **Transpower** must certify in writing, that having made all reasonable enquiries, it is his or her belief that-
 - 20.1 the information was derived from and accurately represents in all material respects, the operations of **Transpower**; and
 - 20.2 the **opex** disclosures comply in all material respects with the requirements of this notice.
- 21. For the avoidance of doubt, certification for **Transpower's base capex proposal** are set out in clause 9.1.1 of the **Capex IM**.

Information format

- 22. The information required by this notice must be supplied in 'unlocked' MS Excel or MS Word format as appropriate, so that we can easily transfer information (ie, able to be 'copied and pasted').

Publication of supplied information and confidentiality

- 23. The Commission may publish the information provided by **Transpower**.

24. Any data or information provided to the Commission in response to this notice that **Transpower** considers is confidential, must be provided in an appendix or separate electronic file that is clearly marked as confidential.
25. **Transpower** must provide the Commission with reasons why the particular data or information is confidential.
26. In the event that the Commission agrees that this data or information is confidential, **Transpower** must provide the Commission with both confidential and public versions of its disclosure. The responsibility for ensuring that confidential information is not included in a public version of a disclosure rests entirely with **Transpower**.

Date of response

27. **Transpower** must supply the specified information to us by email to the following address: regulation.branch@comcom.govt.nz by no later than 5 pm on 2 December 2013.
28. Should you have any queries on this notice, please send them to Matthew Lewer, Chief Adviser, Regulation Branch c/o regulation.branch@comcom.govt.nz.

Dated at Wellington: 2nd July 2013

Yours sincerely,



Sue Begg

Deputy Chair

