

28 November 2017

Catherine Jones
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Transpower
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By email

Dear Catherine

Capex input methodology review – Table 1 in our draft decision paper

1. Thank you for your letter dated 24 November 2017 requesting that we correct Table 1 in our draft decision paper for the review of the Transpower capex input methodology (capex IM).¹

The issues raised by Transpower

2. Your letter raises three issues relating to Table 1:
 - 2.1 The heading of column 2, 'RCP2 allowance in IPP (Commissioned value 2016/17 prices)', is not reflective of the way the numbers in that column have been calculated;
 - 2.2 Columns 2 and 3 have not been calculated on a comparable basis, and their positioning side-by-side may lead readers to draw incorrect conclusions about Transpower underspending its RCP2 allowance; and
 - 2.3 The comparison of Columns 2 and 3 (which Transpower considers to be an incorrect comparison) may have influenced our draft decisions.

Why we included Table 1 in our draft decision paper

3. Table 1 is provided as context for the chapter on incentive mechanisms. We included it to show the relative scale of the different categories of capex (eg, the size of base capex, relative to listed capex, relative to major capex) ahead of a discussion on the different regulatory incentives applying to these capex categories. The table illustrates the relative size of the different categories of capex both in terms of Transpower's RCP2 allowance, and in terms of Transpower's most recent published forecasts.

¹ Commerce Commission "Transpower capex input methodology review: Draft decisions" (15 November 2017), page 24.

The heading of column 2

4. We acknowledge that the heading of column 2 could be expressed more precisely. It would have been more precise to refer to 'expenditure' rather than 'commissioned'. For the purpose for which we included that column (explained above), this lack of precision has little bearing.

The comparability of columns 2 and 3

5. We acknowledge that the figures in columns 2 and 3 have not been calculated on a comparable basis.²
6. As noted above, we did not intend for this comparison to be drawn (ie, we intended for each column to be read top to bottom, rather than for rows to be read left to right). However, we appreciate that the positioning of these columns side by side may lead some readers to compare the two.
7. We note that your letter of 24 November 2017 provides what Transpower believes to be a more appropriate comparison.³

The influence of a comparison between columns 2 and 3 of Table 1 on our draft decisions

8. The comparison of columns 2 and 3 in Table 1 had no bearing on our draft decisions. As noted above, we did not intend for such a comparison to be drawn.
9. The references in our draft decision paper to the risk that Transpower may overstate its expenditure forecasts when seeking regulatory approval is recognition of a risk that exists irrespective of any observations about what might have happened in the past. The risk of a regulated business overstating its forecasts is a well-established risk for regulatory regimes such as ours, and is often an important consideration when seeking to make decisions for the long-term benefit of consumers.
10. As noted in our draft decision paper, we consider that the risk of overstatement of forecasts is likely heightened in a regime in which an *ex-ante* incentives framework plays an increasing role in encouraging Transpower to operate efficiently.⁴

Both letters to be published

11. For the benefit of other stakeholders, we will publish your letter of 24 November 2017, alongside this letter, on the capex IM review page of our website.⁵

² The workings for our calculation of the figures in column 2 are provided in footnote 43 of the draft decision paper. The figures in column 3 come from Transpower's 2017 ITP.

³ We note that Transpower's heading for column 2 in the table appended to your letter of 24 November 2017 could perhaps reflect that the RCP2 allowance figures in that column have been adjusted by Transpower to be comparable with the approach taken by Transpower in its 2017 ITP.

⁴ See, for example, paragraphs 47, 85, 90, and 94 of our draft decision paper.

⁵ <http://www.comcom.govt.nz/capex-input-methodology-review/>

12. Please do not hesitate to contact me if you have any questions about this letter.

Yours sincerely,



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