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Keeping the energy flowing

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Input Methodologies Review 2023: Cross submission - Draft Framework Paper and Process and Issues Paper

Transpower welcomes the opportunity to cross-submit in relation to the Commerce Commission's (the Commission's) Input Methodologies (IMs) Review 2023 draft Framework Paper and Process and Issues Paper.

RAB indexing

We support the Commission considering whether a non-indexed approach should be adopted for other regulated suppliers, including whether regulated suppliers should be given the choice between an unindexed and indexed approach. The optimal approach may depend on various factors, including the extent of future investment requirements. We agree with Vector that "*different regulated businesses have different investment needs, access to further equity, and funding approaches*".¹ This is reflected, for example, in Chorus' preference for an indexed RAB for its regulated fibre business under Part 6 Telecommunications Act.

Vector submitted that "[t]he back-loaded cashflow profile is creating significant difficulty for regulated business to finance their investment programmes".² This same issue would apply to Transpower if our RAB were indexed, particularly if it was indexed without accelerated depreciation.

We do not support the view that Transpower's RAB should be indexed (i.e. Contact Energy) or that Transpower's RAB should be indexed if the Commission does not adopt a non-indexed approach for other regulated suppliers (e.g. Vector).

¹ Vector "Submission on the IM Review 2023 Process and Issues Paper" (July 2022), p. 17

² Vector "Submission on the IM Review 2023 Process and Issues Paper" (July 2022), p. 34

The Commission has been clear that accelerated depreciation and non-indexed RAB can be substitute ways of bringing forward capital recovery and that if accelerated depreciation is adopted a non-indexed RAB approach is not needed.³

We note Orion's view that *"The two mechanisms have worked well for Transpower (unindexed) and EDB's (indexed) up to this point", "Orion recommends both options are kept in the IM's [sic]" and "We support Transpower for the most appropriate approach to support their business funding requirements".*⁴

EDBs emphasised that the principle of "financeability" should be applied in the IMs. If material changes are made to the IMs that affect regulated businesses' ability to finance investment, then we support consideration of introduction of a financeability test.

Split WACC

MGUG raised that the Commission should consider whether to adopt a split cost of capital. We do not consider that any new points were raised that require the Commission to revisit its views on this matter.

A trailing average cost of debt approach should be adopted

The only submission against a trailing average approach was provided by BARNZ.

We note and agree with Unison's following points:

"Had the DPP reset been scheduled for 2021, a WACC in the low 3% range would have resulted, yet two years later, a WACC struck on current market data would be approaching 7%."

and

*"These extremes have highlighted that the approach to setting the risk-free rate on a three month window potentially can cause quite volatile outcomes that then become locked in for a five year period. It is not evident that this concentration risk is to the long-term benefit of consumers ..."*⁵

Consistent with our own submissions, First Gas has submitted that *"the measured cost of debt can change significantly from one regulatory determination to the next in a way that looks a lot like a lottery"*.⁶

³ Commerce Commission, Default price-quality paths for gas pipeline businesses from 1 October 2022, Draft reasons paper, 10 February 2022, paragraph 6.98.1.

⁴ Orion "Submission on the IM Review 2023 Process and Issues paper and draft Framework paper" (July 2022), p. 32

⁵ Unison "Submission on Input Methodologies Process and Issues Paper and Draft Framework Paper" (July, 2022), p. 16

⁶ FirstGas "Submission Part 4 Input Methodologies Review 2023 Process and Issues Paper and Draft Framework Paper" (July, 2022) p. 25

We consider that the Commission should review the reasoning provided by the AER for preferring the trailing average approach, cited in the Incenta report⁷ for Chorus on “Measures to improve stability in WACC estimation”, including that:

- *“It smooths movements in the return on debt over a number of years, which would result in lower price volatility for energy consumers and more stable returns for investors than the “on the day” approach.”*
- *“It minimises the consequence of a single measurement error.”*
- *“It is more reflective of the actual debt management approaches for non-regulated businesses and, therefore, it is more likely to represent efficient financing practice.”*

We note and share the Chorus/Incenta’s view that any potential windfall gains/losses from a switch to trailing average could be avoided by adopting transitional arrangements. We support consideration of the type of transitional arrangements Chorus/Incenta and FirstGas detailed in their submissions e.g. following AER precedent in Australia. In our submission on the 2016 IM Review, we also recommended a transition.⁸

Support for prudent enabling investments

We note some other submitters support the need for investments to ensure a smooth transition to a low carbon economy. For example:

“Meridian understands that EDBs and Transpower may need to able [sic] to use a more forward-looking approach to forecasting for price-quality paths rather than an approach based on historic expenditure. In some cases where there is high confidence of demand growth, it may be prudent to enable investment to occur ahead of demand.”⁹

and

“In Meridian’s opinion, then IMs and IPP should enable Transpower to increase the resources it has at its disposal to deal with volatile and increased connection enquiries.”¹⁰

Linked to this, we note support for the Commission to consider a lower discount rate for the Investment Test. Contact submitted that “A lower standard discount rate is more consistent with international best practice), including the evidence it has provided that the current discount rate is outdated and in relation to OECD (including New Zealand) benchmarks.”¹¹

Transpower agrees with Chorus that “It is helpful to explore how investment tests in the IMs and other expenditure criteria can best reflect changing market conditions across multiple regulated sectors”.¹²

⁷ Refer to report [Measures to Improve the stability in the WACC estimates](#)

⁸ Transpower, Input methodologies review: Technical consultation on updates to draft determinations, 3 November 2016, Appendix C.

⁹ Meridian “Submission on Input Methodologies Process and Issues Paper and Draft Framework Paper” (July, 2022), p. 2

¹⁰ Meridian “Submission on Input Methodologies Process and Issues Paper and Draft Framework Paper” (July, 2022), p. 5

¹¹ Contact “Submission on Input Methodologies Process and Issues Paper and Draft Framework Paper” (July, 2022) p. 3

¹² Chorus “Submission on Part 4 input methodologies review” (July, 2022), p. 3

Can the Commission determine a new IM not covered by the existing determination?

We share Vector's position that "[w]e are not convinced by the Commission's statement in the Draft Framework Paper that it cannot make additional IMs".¹³ Transpower continues to be of the view that new IMs are permissible under Part 4 Commerce Act.

The Commission has stated that:

"We consider that legislative developments since the 2016 IM review have affirmed our preliminary view on the scope under Part 4 for IMs on new matters. ...section 178 of the Telecommunications Act: ... explicitly permits us, at any time after the implementation date, to determine further IMs for FFLAS."

"We consider the absence in Part 4 of such express permission to determine further IMs in equivalent terms to section 178(2) of the Telecommunications Act shows parliamentary intent to distinguish Part 6 from Part 4 in this respect."

We consider that this argument is somewhat circular. Submissions made in relation to the Telecommunications (New Regulatory Framework) Amendment Bill (notably from Transpower and 2degrees) successfully submitted that section 178(2) be added as a 'for the avoidance of doubt' clause because of the way the Commission had interpreted Part 4 Commerce Act as excluding new IMs. Transpower submitted:

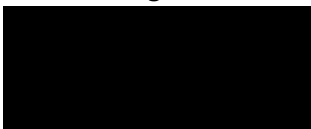
"The Commerce Commission presently holds the view that it cannot introduce new IMs. This would seem like an unnecessary, and unintended, restriction which could be readily resolved through clarification to the existing Part 4 legislation."

The clause was not introduced because Part 4 of the Commerce Act necessarily excluded new IMs but to ensure that it was not any question that new IMs could be added under Part 6 Telecommunications Act.

Other point

We note that there was an error in our submission. On page 31 of our submission, the last sentence should have read "*CEPA concluded that the opex and capex financial incentives were not equal*".

Kind regards,



Joel Cook

Head of Regulation

¹³ Vector "Submission on the IM Review 2023 Draft Framework Paper" (July 2022), p. 7