



12 December 2017

Keston Ruxton  
Regulation Branch  
Commerce Commission  
Wellington  
By email: [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz)

Dear Keston

## Capital Expenditure Input Methodology draft decisions

We welcome the opportunity to submit to the Commerce Commission on its draft decisions following its statutory review of the Capital Expenditure Input Methodology (Capex IM).

The purpose of the Capex IM is to promote certainty for ourselves and consumers in relation to the rules, requirements, and processes applying to our Individual Price-Quality (IPP) regulation.<sup>1</sup> We agreed with and supported the role of the change criteria<sup>2</sup> to focus the review and limit amendments. The Commission's decision to also conduct an effectiveness review (which we support in principle, but were unaware of) has increased the scope of our analysis to respond effectively to draft decisions that affect many aspects of our business for the next regulatory period. We appreciate the extension granted for this submission.

The Commission has had to conduct its review constrained by the timing for our next base capex proposal due December 2018, a process already well in train.<sup>3</sup> At the time of final determination of the Capex IM, proposed for March 2018, Transpower will be scrutinising and challenging the first draft of the expenditure for the RCP3 proposal. Some of the draft decisions that will affect our RCP3 proposal appear to be costly and complex to implement for unquantified benefit.

We provided information to the Commission,<sup>4</sup> focussed on the third change criteria "significantly reduce compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s52A purpose)". We are aware of the effects of our expenditure on prices and our business improvement activities are focused on obtaining efficiencies, more accurate forecasting and overall governance of capital investment.<sup>5</sup>

As grid owner, our investment obligations are first to meet reliability needs and second to identify opportunities for economic investment.<sup>6</sup> We agree with Professor Yarrow that economic assessments "*...necessarily involve forecasts of the future, and actual market outcomes will depend on a set of information that is far larger than anything that can be possibly known by the decision maker, not least because part of the information set will not be known by anyone at the time of the decision (it will be discovered later)*".<sup>7</sup> We interpret the decision maker as us and the Commission.

---

<sup>1</sup> Commerce Act 1986 section 52R

<sup>2</sup> [Transpower submission](#) to focus areas, June 2017

<sup>3</sup> Transpower and the Commission have started the regulatory process under 2.2.1

<sup>4</sup> Transpower submission to [Process update paper](#), July 2017

<sup>5</sup> [Transpower letter](#) 'Table 1 incorrect information comparison' to CC 24 November 2107

<sup>6</sup> Via grid reliability report 12.114 and GRS, and grid economic investment report 12.115

<sup>7</sup> Professor George Yarrow, Review of Input Methodologies (Electricity Distribution Services and Gas Pipeline Services) Draft Reasons Paper

Our view is that the Commission's incentive regulation enhances innovation and discovery of processes to reveal efficient costs for our services. To enable timely investment in a dynamic environment, we consider it imperative our capex rules do not unduly constrain our flexibility to manage uncertainty.

In our submission, we discuss:

- regulation for uncertainty as applied to enhancement and development (E&D) < \$20m and major capex
- our incentives to not overstate our expenditure
- the value of draft decisions for further scrutiny: base capex stakeholder engagement including demand forecasting; system and service benefit description, and charge changes.

In the appendices, we:

- evaluate our proposal for E&D < \$20m against the Commission's proposal [Appendix A]
- respond to each draft decision, including decisions on Schedule F, and indicate where we are likely to suggest changes to the drafting in the draft determination<sup>8</sup> [Appendix B].

## Managing forecast uncertainty

**Proportionate scrutiny principle.** Through successive regulatory periods, the threshold for individual enhancement project scrutiny has lifted from \$1.5m to \$5m to \$20m. We agree with the Commission's reasons, including the 'proportionate scrutiny principle',<sup>9</sup> for deciding to retain the \$20m threshold for major capex applications.

**Enhancement and Development new administrative mechanism.** We strongly oppose the Commission's draft decision to regulate uncertainty of E&D expenditure under \$20m via a baseline level with administrative update(s) using a demand trigger. We view this mechanism to be a disproportionate amount of administrative scrutiny that appears to be at odds with the decision above. Applying the proposed E&D mechanism is likely to affect our ability to invest in a dynamically efficient way (investing in the right projects at the right time).

Transpower currently manages base capex uncertainty, including for E&D expenditure by using the lever of substitutability. E&D makes up less than 10% of base capex and is subject to greater uncertainty than the rest of base capex for replacement and refurbishment. Peak demand is only one of several drivers of uncertainty for E&D. Other drivers include changes in generation, demand profiles and smarter use of technology. Drivers may occur on their own or in combination. If demand is used as the trigger, when other drivers are more important, it could result in investment occurring before it is needed and other investment occurring after it is needed.

We consider the proposed trigger based on actual demand (or forecast demand) values will be ineffective in managing the delivery of upgraded grid service. If a grid need exists when the actual demand value is 80MW, then a demand trigger at 80MW would apply too late for Transpower to respond in time to meet the need. If forecast demand is the trigger, then Transpower already uses this forecast demand to ensure timely grid investment for grid reliability.<sup>10</sup>

---

<sup>8</sup> Indication is not exhaustive; we will respond to the draft determination on 21 December.

<sup>9</sup> *Para. 46. We will therefore continue to apply direct scrutiny where we consider the benefits of such scrutiny to consumers outweigh the associated costs. (These costs can be immediate costs on us or Transpower, or long-term costs (eg, prescriptive requirements that can lower the ability of Transpower to make efficient investment decisions)).*

<sup>10</sup> Grid reliability report under EIPC 12.114.

Uncertainty is driven by demand from known and unknown entities and emerging decisions of stakeholders. During RCP2, we have cancelled, deferred and added projects based on information as it arose. For small E&D projects, the trigger mechanism is likely to introduce inefficiency and stifle our ability to respond to stakeholder needs on a timely basis.

We suggest a revised approach to manage the E&D uncertainty for our RCP3 proposal as described in our July 2017 Transmission Planning Report.<sup>11</sup> In Appendix A we evaluate the Commission's proposal against ours, using the criteria of efficiency, investor expectation and ability to implement.

Based on our evaluation, we conclude that the Commission's proposed approach to E&D uncertainty management will cost more, be less adaptive and responsive to external drivers, and less dynamically efficient, than our proposed approach.

**Incentives to manage large project investment risk.** We support the Commission's changes to the incentive framework for major capex, and changing the incentive rate (risk sharing ratio) for major capex and listed projects to recognise investment risk.

**Major capex approval process.** We consider the revised incentive settings and more flexible approval approach will create productive and dynamic efficiencies in our major capex investment processes.

Although we consider our expected costs (P50) for a major capex project will benefit from the process changes such as staged approvals, any proposed changes to the P50 level by the Commission after application would need robust justification. The process for project approval should include a draft determination so that Transpower has a right of reply. We note that any determination for the cost of non-transmission solutions (NTS) under major capex should recognise the potential for asymmetrical risk distribution when managing for unknown demand.

## Application of incentives to base capex

The Commission's incentive regulation encourages the delivery of projects and programmes, to meet needs, to efficient cost. Transpower's internal governance challenges bottom up engineering assessment against top down views of need, deliverability and impact on customer prices.

Our base capex forecast need and costs are based on the best available information at the time each proposal is put together (up to seven years in advance of delivery). This information includes actual costs from previous works as a product of efficiencies encouraged by incentives. Continual feedback allows better information that reveals efficient costs, which may increase or decrease over time.<sup>12</sup>

We agree with the Commission that there could be a theoretical risk that Transpower has incentives "to overstate the opex and capex allowance it needs to recover at the time we set the IPP..."<sup>13</sup> However, even if Transpower could consistently implement such a strategy, we do not consider the short term financial benefits outweigh the potential detriment in the long term.

Our wider incentive is **not** to deliberately overstate costs, because:

- stakeholders, including our government shareholder, expect our services to be affordable
- we must stay relevant as our natural monopoly status may be eroded by the emergence of substitutes for our services

---

<sup>11</sup> [Section 4.1](#) Transmission Planning Report September 2017.

<sup>12</sup> Analysis of RCP2 costs to date for six replacement and refurbishment (R&R) portfolios show increased unit rates for five of the six portfolios compared to the unit rate used in our RCP2 proposal.

<sup>13</sup> X17 draft decision.

- our revenue reset process repeats every five years so integrity and credibility are important for the long term, as stability of regulatory arrangements affects investor confidence. Systematic overstatement of costs would become apparent over time
- the Commission has wide range of reserve powers for information provision and control.

## Scrutiny that adds value

Transpower endeavours to produce information that is useful and relevant for stakeholders both voluntarily and as required by regulation. Our individual price-quality regulation, coupled with information disclosure regulation, creates a comprehensive set of information for scrutiny.<sup>14</sup> In addition, we produce an annual report and undertake targeted community and landowner communications activities on projects forecast for delivery in specific locations.

Producing information for scrutiny (including preparing, publishing, holding workshops and hosting presentations) is not costless activity. We support the role for appropriate and effective scrutiny by the Commission and stakeholders which can add value to the decision processes for the Commission, stakeholders, and us.

We consider projects with scope for several options and with cost uncertainty (such as grid enhancement and reconductoring projects) benefit from a diversity of input. We agree with the Commission's expectation that replacement and refurbishment projects<sup>15</sup> are less likely to provide opportunities for alternative solutions than enhancement projects.<sup>16</sup>

**Annual reporting on base capex stakeholder engagement.** We agree with the Commission's view<sup>17</sup> that engagement is an important part of the base capex investment decision making process. The Commission has its own consultation obligations after we submit a base capex proposal (or major capex proposal).<sup>18</sup>

We consider the five-year cycle, combined with the annual processes under IPP and ID, already provide opportunity for scrutiny and engagement on our investment plans. We only support additional reporting under information disclosure on our base capex stakeholder engagement, where it is fit for purpose and the benefit outweighs the cost.

**Reporting on demand forecasts.** We understand the interest of stakeholders<sup>19</sup> in our demand forecasting processes in a context of mostly flat load growth for 10+ years, the emergence of disruptive technology and greater availability of data and tools for third parties to develop approaches to forecasting.

Our existing consultation on demand forecasts comprises:

- bilateral communication between our contracted customers to obtain forecasts at their points of supply to inform our point of supply peak forecasts
- consultation with stakeholders about the forecast(s) for any major capex or listed project.

We agree that reporting on our stakeholder engagement could include demand forecasting (for example, every two years could be effective).

---

<sup>14</sup> Including our Integrated Transmission Plan, Transmission Planning Report and Asset Management plan.

<sup>15</sup> For example, volumetric programmes for asset management such as tower painting, circuit breaker replacement and insulator replacement.

<sup>16</sup> Incentive paper para 64.

<sup>17</sup> Para. 270 draft decisions.

<sup>18</sup> Capex IM Part 8, 8.1.1 (1) and (3).

<sup>19</sup> The Commission references submissions on demand forecasts by MEUG, IEGA and ENA, para.282.

## Information on investment benefits and charge changes

**System and service benefits.** We support investment rationale that describes the benefit produced by proposed expenditure. Listed and major capex project proposals already provide for description and quantification of benefits under the cost-benefit analysis of the investment test, Schedule D.

We consider the proposed new obligation<sup>20</sup> for quantitative estimates for base capex proposals to be unreasonable because:

- most base capex is for replacement and refurbishment investment that is not amenable to system and service benefit description: asset replacement and refurbishment are defined to **not** improve original service potential<sup>21</sup>, and refurbishment is to extend economic life.
- E&D expenditure is amenable to specific project quantification, only after options investigation. Our proposed approach to the E&D portfolio is via an aggregate quantification (see Appendix A)

For base capex proposals, we consider the qualitative information at the time of the proposal, as well as periodic updates, provide efficient opportunities for consumers to review and engage with the benefits of our proposed investments.

**Transmission charge changes.** We understand the interest of stakeholders regarding how transmission investment flows through to their charges. However, for base capex proposals, we consider the proposed requirement is not reasonably possible. The issues are:

- difficulty in creating a credible counterfactual against which to assess the change
- deciding in advance which pricing year to apply any change in revenue to individual charges
- explaining the above processes to customers to ensure the information is relevant.

We consider the proposal for base capex would be unworkable in practice. Addressing the issues above would be complicated and we would forego more valuable business activity.

For listed projects and major capex we consider the proposals (and the draft rule) may have merit, though we caution that charge information to customers would always be incorrect and potentially likely to mislead due to reliance on input assumptions.

Our grid services must remain relevant as increased options emerge for consumers to source and manage their electricity needs, and Transpower must adapt its operations to respond appropriately. Accordingly, we seek to reduce existing untargeted, broad prescription in regulation to support increased flexibility for dynamically efficient investment, with appropriate stakeholder engagement.

Yours sincerely



Catherine Jones  
**Regulatory Affairs and Pricing Manager**

---

<sup>20</sup> Proposed drafting Part 7 subpart 5 (2) *All proposals and applications ... must include to the extent reasonably possible (a) a description of the expected service benefits that will be delivered by the proposed investment; (b) a description of the expected system benefits that will be delivered by the proposed investment; and (c) a quantitative estimate of the expected system benefits...*

<sup>21</sup> Refer 1.1.4 capex IM determination for definitions of **asset replacement** and **asset refurbishment**.

## Appendix A: Evaluation of E&D policies proposed by Transpower and the Commission

In this appendix, we:

1. outline our own proposal for managing uncertainty for E&D expenditure
2. evaluate our proposal against the Commission's using the criteria of efficiency, investor expectations, and implementation.
1. [Transpower proposal for establishing an appropriate funding level for E&D expenditure for RCP3 \(as outlined in the TPR<sup>22</sup>\)](#)

We considered the investment proposals identified in the TPR that we expect to represent system needs in RCP3. We used the investment proposals to establish scenarios representing potential portfolio expenditure. Significant uncertainties within the planning period make it difficult to accurately forecast which system needs will eventuate. The scenarios should not be viewed as a prescriptive list of investments that we will deliver in RCP3. To ensure we maintain dynamic efficiency within the portfolio we continually review investment requirements within the period as new information becomes available. We expect a number of investments may be deferred beyond the RCP3 period, and others may be brought forward. Also, new system needs are likely to be identified.

1. **Establish a high expenditure scenario.** We take a relatively expansive (but plausible) view of the investment needs that could arise, in which period the costs will land and how project timing could be impacted by delivery performance. We also include an allowance for unidentified needs that may arise during RCP3 due to uncertainty in the external environment driving transmission investment.
2. **Establish a low expenditure scenario.** We include high certainty projects, but take a relatively cautious (but plausible) view of the other investment needs that may arise during RCP3. A smaller allowance is made for unidentified needs that may arise during RCP3.
3. **Establish an appropriate position within the range.** We apply our technical expertise to make an informed judgement regarding both individual project and overall uncertainty, and consider the impact of requiring either more, or less, funding than the baseline amount requested.
4. **Establish an appropriate profile for the RCP3 funding baseline.** We start from an assumption of even phasing of work, then consider reasons why we may want to depart from this assumption.

Scenario costs summary	Funding (\$m)
High: includes roll-in projects, known needs for RCP3, and unknown needs for RCP3	115 (23 per year)
Low: known, high certainty projects, assume deferred needs from RCP3	65 (13 per year)
Appropriate position in the range	90 (18 per year)

---

<sup>22</sup> [Transmission Planning Report September 2017](#) section 4

<https://www.transpower.co.nz/sites/default/files/publications/resources/Transmission%20Planning%20Report%20Final.pdf>

## 2. Evaluation of Transpower and Commerce Commission proposals

	<b>Transpower’s proposal for E&amp;D expenditure</b>	<b>Our interpretation of Commission’s proposal (paras. 155 – 157)</b>
<b>Proposal</b>	Propose an amount for RCP3 that is a mid-range between high and low expenditure scenarios.	Propose a baseline amount for RCP3. At the same time, specify an additional amount to cover additional expenditure for certain projects each ‘triggered’ by a demand figure.  Any additional amount is ‘automatically’ added to allowance when the trigger occurs. We assume an update to revenue is needed as each demand trigger is reached.
<b>Problem definition:</b> how to determine an appropriate expenditure amount in base capex, under uncertainty	Uncertainty from <ul style="list-style-type: none"> <li>• Demand (peak and profile) including from technology effects</li> <li>• Generation</li> <li>• Commercial investment decisions/timing from others e.g. industrial development, urban growth</li> <li>• Changing expectations of service levels from customers</li> </ul>	Uncertainty from <ul style="list-style-type: none"> <li>• Demand (peak)</li> </ul>
<b>Dynamic efficiency</b> (right investments, right place, right time)	If E&D expenditure needs to increase, then fungibility within base capex allows us to efficiently reprioritise other work and co-ordinate investment. For example, aligning asset condition issues with enhancement opportunities at a site, or accommodating third party works.	Administration to access funding creates a barrier to efficiency. Funding covers only uncertainty from demand. The combined effect is to reduce dynamic efficiency and our investment co-ordination.
<b>Investor expectations</b> (us, and stakeholders)	Flexibility to co-ordinate our work to accommodate all stakeholders (generators, load, transport, councils) needs.	Third party investment projects only partially met.
<b>Implementation</b> (ready for RCP3 proposal due December 2018)	On track for March 2018 first full view of RCP proposal (for internal governance and challenge). Includes funding level derived as above.	A final Capex IM decision in March 2018 would require Transpower to redo E&D analysis to create a new baseline and derive triggers. The process creates considerable complexity, would absorb scarce resource and necessitate additional internal governance and assurance.

## Appendix B: Response to each draft decision as summarised in Attachment B

The table below outlines our response to each of the draft decisions, and using the references from Attachment B.

Reference	Proposal	Transpower response
B12	Core framework: introduce staged approval.	Agree.
B16	Option of demand-based trigger for E&D.	Disagree – see submission letter and Appendix A.
B20	Base capex expenditure adjustment (move to expenditure based).	Agree.
B24	Restrict CC ability to exclude certain types of expenditure from the base capex incentive (except for base capex that has become major capex).	Agree.
B26	Not remove the requirement for annual incentive calculations.	Agree.
B30	Require Transpower to propose performance based measures and asset health measures, and allow CC to determine asset health grid output measures.	Agree in part. We have raised an issue previously with the Commission regarding the use of current grid output mechanism to determine the grid output adjustment. <sup>23</sup> We seek further use of a pilot to develop a non-mechanistic output framework for the asset health output measures over RCP3, instead of the quantitative grid output mechanism.
B34	Base capex policies and processes adjustment (remove).	Agree.
B38	Base capex incentive rates: (33% standard, 15% listed and 'low incentive rate' projects).	Agree with 15% for listed projects. For the 'low incentive rate' projects, the draft determination (DD) schedule F2 (3) provides for our base capex proposal to identify base capex projects as 'low incentive rate' projects if a project meets criteria of 'no

<sup>23</sup> Refer to Schedule B3 in the Capex IM.



Reference	Proposal	Transpower response
		<p>workable alternative capex or opex options’. Transpower may not be able to conclude whether a project meets this criteria before an RCP proposal (we would need to conduct a full investigation first).</p> <p>We seek the ability for Transpower to be able to re-classify base capex projects to a ‘low incentive rate’ project during a RCP. Also at DD 2.2.2 (3) (a) (ii) and A (4) we seek clarity for how the Commission would determine ‘no workable alternative capital expenditure or operating expenditure options’.</p>
B40	Major capex incentive and output framework - efficiency adjustment (remove).	Agree.
B42	Major capex incentive rate 15%.	<p>Agree. We will propose re-drafting for the new clause C6 for Commission evaluation of the incentive rate. As written, the clause implies that the reason for project cost being ‘so high’ is because of overforecasting, which is incorrect.</p> <p>As the Commission has identified in its draft decisions (refer paragraphs 216 – 218), the estimated costs have large uncertainties due to such early approval and / or change of scope. Table 2 is an incomplete representation of our disclosure of information relating to major capex projects. We provide reasons for all variances. Our information disclosure is available <a href="#">here</a>.</p>
B46	Major capex project output adjustment (retain).	<p>We find this incentive, and the Commission’s decision and explanations for it, to be confusing. The original objective for Schedule B3 incentive (page 54 of the 2012 Capex IM Reasons Paper) was to penalise non-delivery of outputs. However, the drafting (unchanged since 2012) does not have that effect because it requires that the incentive rate is applied to the <i>“aggregate capital expenditure ... that does not deliver the approved ... outputs”</i> – the strict reading of which is that the incentive penalty is calculated as 33% of any capital expenditure that does not relate to (or deliver) any project outputs.</p> <p>We seek clarity on the project output adjustment policy under Schedule B3. One interpretation, (although inconsistent with the Reasons Paper), is that there is a 33% penalty on capex that has been applied to a major project’s costs, but that do not relate to that project [ <i>“aggregate capital expenditure ... that does not deliver the approved ... outputs”</i>]. If such costs were discovered, then we agree that a 33% rate should apply, because those costs should have been recorded against our base capex for the year. However, we reject the suggestion in B46 that a lower incentive rate would incentivise what would be a deliberate and incorrect recording of base capex against a major project.</p>

Reference	Proposal	Transpower response
		We consider that any output changes for efficiency should allow a net major capex expenditure incentive of 15% (or the rate relevant to the project) under Schedule B5.
B50	Major capex framework is ex-ante.	Agree.
B54	Ex-ante regime resolves issue with CPI and Fx and CPI and Fx is symmetric.	Agree.
B57	Major capex incentive rate (set at 15%, with some ability for TP to propose lower).	Agree.
B61	Estimate in change of transmission charges and an explanation of the system and service benefits.	Modify – see submission letter.
B65	Commission decision to undertake effectiveness review for Schedule F at same time.	We agree with the principle of promoting s52 purpose however we consider ‘correcting ambiguities, correct errors’ could have unintended consequences. We will submit on the draft determination drafting, for 21 December.
B66	Listed projects (in base capex proposal, say why listed).	Agree.
B68	Changes to Schedule F	Modify - see below, and in submission on draft determination due 21 December.
B70, B74	Approach to considering non-transmission solutions (increase scope for NTS).	Agree.
B76	Amend scope of consultation requirements for subsequent stages of a major capex project (consultation is commensurate with materiality of changes to matters: need, scenarios, assumptions, investment test).	Agree.
B80	Rules for submitting a major capex proposal (new ‘application date’).	Agree.
B85	Rules for approving or rejecting a major capex proposal (in approval process, CC can determine the P50 amount).	Modify – see submission letter.  For non-transmission solutions (NTS) funded by <i>maximum recoverable costs</i> , actual costs may be highly uncertain. We consider a P50 cost would not be a reasonable maximum cost as it would expose Transpower

Reference	Proposal	Transpower response
		to considerable risk and could act as a disincentive to the use of NTS. We should be able to recover the actual costs of NTS.
B91	Require Transpower to provide, for each affected EDB and direct connect consumer, an estimate of the change in transmission charges and an explanation of the system and service benefits delivered by each proposed major capex investment.	Modify – see submission letter.
B95	No amendment to Schedule G (major capex proposal).	We will suggest any necessary changes to Schedule G that supports the new major capex approval processes (able to stage the approvals) when we submit on the draft determination.
B98	Process requirements for amendment applications (remove amendment of major capex allowance).	Agree.
B102	Certification requirements for proposals and amendment applications (new verification pilot for RCP3 proposal).	Agree. A pilot will be of value to creating an approach to RCP proposals and CC evaluations.
B106 and para 284	Base capex annual reporting requirements (include stakeholder engagement for demand forecasts).	Agree to the extent that engagement is warranted.
B111	Clarify that the requirements for assessing listed projects are those set out in clauses 6.1.1(1) and 6.1.1(2), and in Schedule A2.	Agree.
B117	Retain the current criteria for categorising capital expenditure as either major capex or base capex.	Agree.
B121	Maintain the current requirement for Transpower to submit an ITP annually to the Commission.	Agree.
B124	Maintain the current requirements for consideration of transmission alternatives.	Agree.

Reference	Proposal	Transpower response
B128	Make no changes to the capex IM to place further incentives on Transpower to complete major capex projects on time.	Agree.
B132	Retain the current form and scope of the investment test	Agree
B136	Retain our current approach to the key inputs and calculations that are used in the investment test.	Modify. We consider the Commission should allow itself discretion to review the Investment Test, to have regard to potential decisions to the TPM policy by the Electricity Authority.
B146	Timing and Transition (commencement date for new rules is day after final determination is gazetted, estimated March 2018).	Agree.
B148	We also anticipate requiring Transpower to disclose its calculations for the new adjustments in its information disclosures.	Agree.

**Table 1 – Draft decisions and reasons relating to Schedule F of the capex IM**

The type of evaluation the Commission conducts has implications for the information we provide. For RCP3 evaluation, our view is that it should be an exercise to approve a funding baseline for the incentive based regime to operate, instead of scrutinising a set of projects and engineering practices and procedures. In evaluating our proposal, the focus should be on whether we have correctly reflected our base year level of efficiency into our plans, and whether our approach to sizing our view of funding needs for the future is appropriate. We consider that the Commission would then not need to scrutinise our current level of efficiency, our potential for efficiency gains, or the way we manage our business day-to-day from an engineering perspective.

Our response is set out in column 4. Our insertions to some information in column 2 are to better reflect what Transpower proposed and why.

Clause	Transpower’s proposed changes	Draft decisions and reasons	Our response (DD = draft determination)
F2 – List of identified programmes, listed projects and projects subject to low incentive rates	Remove ‘base capex projects’ and reduce the level of prescription.	<p>Our draft decision is to retain base capex projects in this clause. We expect there will still be base capex projects that need to be identified, such as E&amp;D projects and outdoor to indoor conversions. When assessing listed projects, we propose to treat them as identified projects rather than programmes.</p> <p>We propose to reduce the level of prescription in some of the sub clauses to increase flexibility and reduce complexity, and to clarify that this clause requires a list.</p> <p>Our draft decision is also to require Transpower to provide a list of listed projects, and projects to which the lower incentive rate will apply, and explain how these projects meet the criteria in the capex IM. Our reason for this proposed change is set out in paragraph B38 above.</p>	<p>We agree with the changes the Commission has made to F2 to clarify the criteria for determining identified programmes.</p> <p>For the ‘low incentive rate’ projects, the draft determination (DD) schedule F2 (3) provides for our base capex proposal to identify base capex projects as ‘low incentive rate’ projects if a project meets criteria of ‘no workable alternative capex or opex options’.</p> <p>Transpower may not be able to conclude whether a project meets this criteria before an RCP proposal (we would need to conduct a full investigation first).</p> <p>We seek ability for Transpower to re-classify base capex projects to low incentive rate during RCP.</p> <p>Also at DD 2.2.2 (3) (a) (ii) and A (4) we seek clarity for how the Commission would determine ‘no workable alternative capital expenditure or operating expenditure options.’</p>

Clause	Transpower's proposed changes	Draft decisions and reasons	Our response (DD = draft determination)
F3 – Overview	Amend wording so it is clear we require an overview rather than details.	Our draft decision is to amend some sub clauses to better reflect that the intent of this clause is to provide an overview rather than detailed commentaries (better promotes s 52R).	We agree with the Commission's draft decision with respect to F3.
F4 – Governance, policies, process and consultant reports	Change 'policies and processes' to 'governance' and remove the requirement to describe material changes to policies and processes since the last IPP determination.	<p>Our draft decision is to change 'policies and processes' to 'governance' and define governance as including policies, processes, strategies and risk assessment. The proposed change is to clarify the intent of this clause (better promotes s 52A).</p> <p>Our draft decision is to change clause F4(2) to require description of changes that affect the expenditure forecasts or performance measures. For example, in RCP2, Transpower has changed its policies, lifecycle strategies and risk appetite for power transformers and this has reduced the value of power transformer replacement capex and could potentially influence opex/capex trade-offs (reduces cost and complexity).</p>	<p>The changes have materially increased requirements and the scope of information provision (in addition to policies and processes, new requirements are 'strategies and risk assessments').</p> <p>We disagree with the Commission increasing the information requirements in F4(1). The change is made without sufficient justification or evidence to demonstrate how the changes better promote the outcomes sought by 52A.</p> <p>The role of our proposal for 'governance' was to describe key internal <b>processes</b> that describe how expenditure is governed. We consider Transpower is best placed to decide the appropriate documentation to convey our governance processes.</p>
F5 – Cost and efficiency	Remove this requirement  <i><u>[because "under the regulatory framework created by the Commission we should be relying on the</u></i>	Our draft decision is to retain clause F5 because this requirement is included so that the Commission can assess the extent that the efficiency gains made in the current regulatory period are reflected in the	We retain the view expressed in our <a href="#">additional information</a> in support of our 24 June submission on focus areas for the Capex IM review. We were asked to propose any specific information requirements that should be added, amended or removed. We have included in the 2nd column our rationale for our conclusion that the requirement should be removed. Our view has not changed.

Clause	Transpower's proposed changes	Draft decisions and reasons	Our response (DD = draft determination)
	<p><i>expenditure incentives to encourage us to search for and reveal efficiencies. The expenditure efficiency arrangements should reinforce an approach where our proposal for the next regulatory period allows for the revealed efficiency i.e. take our efficiency as achieved up to the forecasting base year.</i>"</p>	<p>proposal for the next regulatory period (better promotes s 52A).</p>	<p>For RCP4 when Transpower has performed through two periods of full incentive regulation, plus annual reporting under information disclosure, we propose this clause is removed as we consider it will be redundant.</p>
<p>F6 – Information and programmes and identified programmes</p>	<p>Remove the requirements to describe:</p> <ul style="list-style-type: none"> <li>• delivery;</li> <li>• changes from historical costs and contingencies;</li> <li>• the link of the programme with long-term grid development;</li> <li>• departures from policies; and</li> <li>• approach to prioritising system growth projects.</li> </ul>	<p>The requirements set out in this clause are necessary to assess identified programmes. Our draft decision is to retain the current requirements and, where necessary, amend or move sub clauses that need to be clarified. For example, since the current sub clause F7(2) relates to identified programmes, our draft decision is to move this sub clause to clause F6(5) for clarity.</p>	<p>We agree with the changes made to flexibility to provide useful information in a revenue proposal evaluation, for example, see changes to F6(2)(b).</p>
<p>F7 - Procurement</p>	<p>Remove this requirement.</p>	<p>Our draft decision is to include a description of the procurement process for the base capex in this clause and move the details on</p>	<p>We retain the view expressed in our <a href="#">additional information</a> in support of our 24 June submission on focus areas for the Capex IM review. We were asked to propose any specific information requirements that should be added, amended or removed.</p>

Clause	Transpower's proposed changes	Draft decisions and reasons	Our response (DD = draft determination)
	<p><u>[We did not say "remove this requirement".</u></p> <p><u>We requested 'lift up level of detail' to provide an overview of the procurement process, including an explanation of the extent to which the process was competitive, and if not, why not.]</u></p>	<p>procurement of identified programmes for clause F6.</p> <p>These details are useful in identifying any deliverability issues, potential areas of high cost, and the appropriateness of Transpower's outsourcing. The proposed changes will promote s 52A.</p>	<p>The Commission has provided no justification (no intervention logic) to demonstrate how its proposed change better promotes the outcomes sought by 52A.</p> <p>For the new sub clauses in F7, we seek to clarify if F7(1) is an overview of Transpower's procurement processes, not covered by F6 (5).</p> <p>Our view is that F7(2) is redundant and replicates information requirements in F8. If there are risks to delivery relating to our procurement methodologies, F8 is sufficient to ensure this information is provided.</p>
F8 – Resourcing and delivery	Remove the details on resourcing and delivery. Transpower suggested removing most of these requirements because they are covered in F3.	<p>Our draft decision is to make no change.</p> <p>F3 provides an overview while F8 provides the details necessary to evaluate delivery of the planned expenditure.</p>	No further comment.
F9 – Other capex	Increase the threshold for categorising minor capex to \$5 million from \$1 million.	Our draft decision is to lift the need to describe the rationale for any forecast base capex to \$5 million. The proposed change will reduce cost and complexity.	The change from is not reflected in the DD.
F10 – Escalation factors and foreign exchange	No change.	Our draft decision is to make no change.	No further comment.



Clause	Transpower's proposed changes	Draft decisions and reasons	Our response (DD = draft determination)
F11 – Information on proposed grid output measures	Remove the level of details on categories of grid output measures and remove the need to describe the relationship between the grid output measures with the risks associated with the grid, the performance of the grid and the key purposes of investments. Transpower queried the need to specify grid output measures by types defined in the capex IM.	<p>Our draft decision is to change clause F11 to clarify the requirements.</p> <p>We consider that defining the measures by types assures stakeholders that the range of grid output measures applying to Transpower covers both its network performance and expenditure objectives.</p>	<p>We query if the changes framed as “to clarify” are the result of the unannounced effectiveness review.</p> <p>We consider the Commission has increased the regulatory burden of providing information, by requiring Transpower to provide all models and supporting data relating to all output measures (both revenue and non-revenue linked). No Part 4 rationale is provided for why the models are needed. We urge the Commission to evaluate its need for information by clarifying how it intends to use all the models.</p> <p>We have deleted the phrase ‘expenditure objective’. Grid output measures are for performance, as described in the Capex IM reasons paper January 2012.<sup>24</sup> Insertion at F 11 (5) repeats information at F13. Suggest delete insertion, or remove F13.</p>
F12 – Revenue linked grid output measures	Remove description to policies and key assumptions.	Our draft decision is to make no change.	Under F12 (c) (ii) we agree that the grid output targets should reflect consumer preferences and thus any consultation responses. We consider the terms ‘relevant policies’ and ‘key assumptions’ have little value, as other information provided in F12 and F11 should be sufficient to evaluate the appropriateness of the output measure targets and degree of consultation undertaken.
F13 – Grid output measures not linked to revenue	Remove the requirements in this clause since they are included in F11.	Our draft decision is to remove clause F13 and include any necessary requirements under clause F11. The proposed change will reduce cost and complexity.	Agree. Clause F13 needs to be removed from the DD.

<sup>24</sup> Capex IM Reasons paper January 2012 section 3.4.6 and 3.4.10