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Brett Woods
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By email: regulation.branch@com.com.govt.nz

Dear Brett

Submission on proposed Transpower IM amendments

We appreciate the opportunity to comment on the Commission's consultation on its proposed amendments to the Transpower Input Methodologies (collectively the Input Methodologies determined in December 2010 and the Capex Input Methodology determined in January 2012). We understand that some of the amendments proposed at this time reflect draft policy decisions on the regulatory framework and may be subject to change following the Commission's RCP2 IPP decision.

The current IM consultation document covers amendment decisions made following the Commission's consultation in March 2014 plus consequential changes necessary to implement draft policy decisions under the IPP framework for RCP2. This submission should be read alongside our submission to the IPP draft decision and reasons paper where we comment on the substantive issues for several of the proposed changes. Our comments in this submission are, in the main, focused on workability and technical drafting. Appendix A addresses all IM amendments from the two consultations. Appendix B provides specific drafting suggestions for *depreciation in year of commissioning* and *catastrophic event* amendments.

IM amendments under March 2014 consultation

The proposed IM amendments give effect to three IM change decisions from the March 2014 consultation¹ and to several matters dealt with in the IPP draft decision and reasons paper. We address the three IM change decisions from the March 2014 consultation here:

- removing the requirement to spread depreciation for end-of-life assets
- strategic land purchases as base capex – 'commissioned' when acquired
- allowing for part year depreciation for assets in the year of commissioning.

Spreading depreciation for end-of-life assets

In the March consultation the Commission accepted our proposal to remove the requirement to spread depreciation for end-of-life assets evenly across a control period. We understand that the Commission has decided to remove the requirement for spreading terminal depreciation evenly across a control period.

¹ Consultation paper (March 11th 2014) available at <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/amendments-and-clarifications/>

We support this decision. However, we note that the IM drafting revisions do not delete the relevant clause 2.2.6(2). We would appreciate assurance from the Commission that this clause will be deleted before the current IM revisions are finalised.

Strategic land

No additional attention is given to this issue in the current IM consultation. In our submission we had raised that *clarification may be needed on the drafting (to be certain that individual strategic land acquisitions may enter the RAB at acquisition) and that it would be helpful and low cost and therefore worth doing*².

We assume that the Commission has reached the conclusion that the current IM drafting is effective for enabling each strategic land purchase made under base capex to be added to RAB on acquisition. We would be content with that decision but would appreciate confirmation of this point from the Commission.

Depreciation in year of commissioning

We welcome the decision by the Commission to address our concerns around the treatment of depreciation in the year of commissioning by aligning regulatory treatment with GAAP treatment from RCP2 and creating a 'pseudo asset' to address the divergence that occurred during RCP1. This is a good example of a non-neutral but efficiency enhancing IM amendment.

We recommend that the Commission's proposed implementation of the pseudo asset mechanism could be simplified. The Commission proposes that the 'physical life' of the 'composite' pseudo asset is based on the weighted average physical life across the many thousands of assets commissioned in RCP1. This approach would generate considerable complexity and create unnecessary assurance cost for no real gain in accuracy.

As a pragmatic alternative, we recommend the Commission specifies a notional life for the pseudo asset. We have analysed assets forecast to be commissioned in RCP1 using portfolio-level estimates of average asset lives. Based on this high-level analysis, we recommend that an asset life of 31 years is adopted for depreciation of the pseudo asset³. This alternative would be value and NPV neutral relative to the Commission's proposal but simpler and less costly to implement. We propose drafting in Appendix B to reflect this.

We note that implementation of the pseudo asset mechanism will require continuation of the practice adopted in RCP1 (and documented as a 'necessary interpretation') of including pseudo asset depreciation within the depreciation revenue building block.

IM changes omitted from this consultation

The Commission has faced a formidable challenge to coordinate overlapping work streams within compressed timeframes. In our view, the Commission has generally done this very well. Two areas where we consider an oversight or misunderstanding may have occurred are⁴:

- the IPP draft decision and reasons paper did not address our request to reclassify some ancillary services costs as recoverable costs. We comment on this issue briefly in our

² Ibid

³ The weighted average asset life for assets commissioned in RCP1 (using portfolio level estimates of average asset lives)

⁴ With reference to the timetable indicated in the Commission's 14 March, 2014 communication to Transpower on addressing proposed IM amendments

submission to that consultation. We would appreciate clarification from the Commission on how it intends to respond to this request.

- the IPP draft decision and reasons paper appears to misunderstand the rationale for our proposal to change from a commissioned to an expenditure basis for setting the base capex allowance. We comment further on the substantive issue in Chapter 7 of our submission to the IPP draft decision consultation including recommending that the Commission revisit its draft decision not to accept our proposal.

A consequence of the Commission's draft decision in the IPP draft decision and reasons paper is that there is no discussion of the issue (and no IM drafting changes) in this IM changes consultation.

We request that the Commission turn its mind to our ancillary services request and, in our IPP submission, that the Commission revisit its draft decision not to accept our base capex expenditure basis proposal. We are available on short notice to assist with any IM drafting changes required to address either point.

IM review and change framework

Looking forward, we are keen to better understand when and how the Commission will consider reviewing and changing the IMs. We think this will enhance the value of the IMs for us as a supplier and for consumers; it may also make the Commission's job easier. We commented briefly on this issue in our May 2014 submission to the Cost of Capital input methodology - where we suggested that the Commission could clarify the 'entry thresholds' for different types of IM change.

With the IMs fully implemented, and reasonable experience of the sorts of issues that crop up, now seems like a good time to (re)consider the IM review policy.

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 A –tabular response to IM amendments

Table 1 Transpower comment on the Commission’s IM amendment proposals

| IM amendment | Comment |
|---|---|
| [proposed under 11 th March 2014 consultation] | |
| Depreciation spreading | <p>We agreed with what was proposed by the Commission in its March consultation.</p> <p>We note that its proposal is not yet reflected in this IM draft determination and anticipate that section 2.2.6 (2) will be deleted.</p> |
| Strategic land | <p>We assume that the Commission is satisfied that the current provisions are already effective for enabling each strategic land purchase (approved under the Capex IM process) to be added to RAB on acquisition. We are content with this outcome.</p> |
| Depreciation in year of commissioning | <p>The Commission proposes that the ‘physical life’ of the ‘composite’ pseudo asset is based on the weighted average physical life across the many thousands of assets commissioned in RCP1. We consider that approach would generate considerable complexity and create unnecessary assurances cost for no real gain in accuracy.</p> <p>As a pragmatic alternative, we recommend the Commission specifies a notional life for the pseudo asset. We have analysed assets forecast to be commissioned in RCP1 using portfolio-level estimates of average asset lives. Based on this high-level analysis, we recommend that an asset life of 31 years is adopted for depreciation of the pseudo asset.</p> <p>We have proposed drafting in Appendix B to reflect this.</p> |
| [proposed under 4th June 2014 consultation] | |
| Terminology change in order to align reconsideration of the price-quality path with the new quality standards | <p>We think the proposed drafting is effective.</p> |
| Adjusting the base capex allowance for ‘listed projects’ | <p>We suggest the drafting at 3.7.4(5)(b) should be the same as at 3.7.5 (2) (g) (ii), as we consider the concept to be the same (and the drafting is clearer for 3.7.5 (2) (g)).</p> |
| Treating forecast major capex as actual opex during the regulatory period | <p>We think the proposed drafting is effective.</p> <p>In addition we consider that the Commission could clarify that this cost can first be approved under a major capex process (as required under 3.1.3 (3)) there needs to be an amendment to the definition of capital expenditure in the Capex IM, for example:</p> <p>capital expenditure means costs that-</p> <p>(a) have been or will be included in a value of commissioned asset, but only to the extent that the costs have been or will be included in a closing RAB value; or</p> <p><u>(b) are associated with a transmission investment but are not and will not be included in a value of commissioned asset; or</u></p> <p>(c) are a non-transmission solution;</p> |
| Additional net opex incurred as a result of a catastrophic event | <p>We think the proposed drafting is effective.</p> <p>Related to this is the current wording of the cost threshold at clause 3.7.1(c)</p> |

| | |
|--|--|
| | (iv) of the same Transpower IM. We comment on problems with the current drafting in our parallel submission ⁵ to the IPP consultation. We repeat our alternative drafting in Appendix B. |
| Forecast CPI for the purposes of setting capex and opex allowances | We think the proposed drafting is effective. |
| Definition of 'related party' | <p>We think the proposed drafting is effective.</p> <p>We query the need for the introduction of the new term 'related party transaction' as we are unsure of the rationale. However in the marked up determination the "related party" in the definition of "related party transaction" is in bold, but it isn't in the consultation paper. For clarity we recommend it should be bold.</p> |

⁵ Transpower submission *Setting Transpower's Individual Price – Quality path for 2015 - 2010*

Appendix B – Drafting suggestions

Depreciation in Year of Commissioning

2.2.9 Adjustment to asset values and establishment of RCP1 pseudo asset

(1) Each asset with a commissioning date in the period commencing

- (a) on the first day of the disclosure year 2012; and
- (b) ending on the last day of the disclosure year 2015,

shall have its values calculated pursuant to-

- (c) clause 2.2.3(1); and
- (d) clause 2.2.3(3),

for the disclosure year 2016 adjusted by the amounts necessary to produce the value for each asset as if depreciation had applied for the disclosure year in which the asset's commissioning date occurred.

(2) The 'RCP1 pseudo asset' is an ~~composite~~ asset established as of the first day of the disclosure year 2016 with -

- (a) an unallocated opening RAB value equal to the sum of adjustments for all assets made under subclause (1) in respect of clause 2.2.3(1);
- (b) an opening RAB value equal to the sum of all adjustments for all assets made under subclause (1) in respect of clause 2.2.3(3); and
- (c) ~~a physical asset life determined pursuant to clause 2.2.6(1)(i)~~ a physical asset life of 31 years where, for the purpose of that clause-
 - (i) the amount of each adjustment made in respect of clause 2.2.3(3) shall be considered the 'opening RAB value' for a component asset with an asset life corresponding to that of the asset adjusted; and
 - (ii) the 'disclosure year' is the disclosure year 2016

Catastrophic event

3.7.1 Catastrophic event

Catastrophic event means an event-

- (a) beyond the reasonable control of **Transpower**;
- (b) that could not have been reasonably foreseen by **Transpower** at the time the most recent **IPP determination** was made; and
- (c) in respect of which-
 - (i) action required to rectify its adverse consequences cannot be delayed until a future **regulatory period** without the **grid outputs** associated with the **revenue-linked grid output** measures being outside the range specified by the relevant cap and **collar** in the remaining **disclosure years** of the **regulatory period**;
 - (ii) remediation requires either or both of **capital expenditure** or **operating expenditure** during the **regulatory period**;
 - (iii) the full costs of remediation are not provided for in that **IPP determination**; and
 - (iv) the cost of remediation ~~net of any insurance or compensatory entitlements would have an impact on the price path~~ over the disclosure years of the IPP remaining on and after the first date at which a remediation cost is proposed to be or has been incurred, ~~by an amount~~ is at least equivalent to \$10 million ~~1% of the~~

aggregated forecast MARRs for the disclosure years of the IPP in which the cost was or will be incurred.

