



21 December 2017

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Regulation Branch
Commerce Commission
Wellington
By email: regulation.branch@comcom.govt.nz

Dear Keston

Capital Expenditure Input Methodology draft determination

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

This letter highlights the main points of our submission¹ to the Commission's draft decision, and Appendix A is a mark-up of the draft determination using comment boxes. Our commentary:

- reflects policy views from our submission to the draft decisions. We have suggested drafting amendment in the comment boxes, rather than direct amendments, so as not to confuse our suggestions with the Commission's amendments
- indicates where we consider drafting could be improved. We propose improvements to address consistency, and reduce repetition and redundancy.

We request the opportunity for an additional drafting review, following the Commission's final decisions, to ensure policy intent and implementation issues are jointly understood before we are required to apply the rules.

The review process

The Commission framed this review in the same way as the broader IMs review, by stating that it would only change the IM where it was likely to:

- promote the Part 4 purpose in s 52A more effectively
- promote the IM purpose in s 52R more effectively (without detrimentally affecting the promotion of the s 52A purpose) or
- significantly reduce compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s 52A purpose).

We were encouraged by these three change criteria, as we considered they would provide targeted policy change and limit unnecessary intervention. Our focus for the review was on framework change to major capex, reducing compliance cost and complexity, and recognising the value of appropriate scrutiny.

¹ [Submission](#) to Capex IM draft decisions 12 December 2017

Reflecting on the draft decisions in the draft determination, we reiterate our support for many of the targeted changes: the ex-ante framework to improve incentives for major capex efficiency, greater flexibility in the major capex approvals to manage uncertainty, and recognition of appropriate risk-sharing for large, individual projects under a P50 approval.

For other interventions, we considered the link to promoting the Part 4 purpose more effectively was not clearly established. For example, new rules for transmission charge detail, benefits quantification for base capex, and additional information requirements in schedule F7 (base capex proposal) will potentially add significant costs for what we consider is speculative benefit.

Effectiveness review. When the draft decisions were released we became aware of the Commission’s parallel effectiveness review to “clarify the existing rules, remove ambiguities, correct errors, or reduce unnecessary complexity and compliance costs”.² While we support the aims of the parallel review, we would have preferred earlier consultation to enable comprehensive analysis. As we considered rules changes consistent with the change criteria, including how we would implement each change, our basis of assessment was the existing rules.

When we examined the draft determination it was not clear to us where clauses had been changed by the change criteria or where clauses had been changed by the effectiveness review. This lack of clarity has introduced uncertainty in our understanding of application of the rules.

Although the Commission may have concluded a number of clauses as ineffective and needing clarification, it is not certain we would have agreed with its conclusions, in our role as the party continuously applying the rules. We consider there is a risk of unintended consequences from independent change. Theoretically minor drafting changes can materially alter meaning and practical application.

We consider the effectiveness review should have identified issues with existing drafting for the project output adjustment policy (Schedule B3), a matter we only realised was an issue while trying to understand draft decisions for Schedule B3 of the draft determination.³

Our commentary on drafting for our main submissions to draft decisions

Consistent with our submission to the Commission’s draft decisions, we indicate below the main areas of the draft determination where we provide detailed drafting comment in Appendix A. The purpose of the commentary is to suggest modification to, or removal of, potential new rules.⁴

- *Enhancement and development expenditure* (decision B16): we request removal of the definition for the draft adjustment mechanism. We strongly oppose the new mechanism. In our submission to the draft decisions we concluded “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.”
- *Asset health grid output measure* (decision B30): we request a revised approach for a less mechanistic method to assess compliance with the new revenue-linked grid output measure.
- *Commission evaluation of major capex incentive rate* (decision B42): we request removal of new clause C6, because we consider the premise of ‘overforecasting’ creates an inappropriate framework for objective evaluation. If a clause is necessary, then we suggest the drafting should recognise the evaluation of foregone benefits to consumers if Transpower considers the investment risk is too great to undertake the investment at the 15% default incentive rate.

² [Draft decisions](#) X26

³ Our [submission](#) to [draft decisions](#), decision B46

⁴ Note we provide drafting comment to a wider set of issues than identified in the list.

- *Service and system benefits, and charges, for base capex proposal, listed projects and major capex projects* (decision B61, B91): we have proposed amendments to Part 7 new sub-part 5 to reduce scope and level of detail.
- *Schedule F (base capex proposal, qualitative information)* (decision B68): we propose several amendments.
- *Commission approval of major capex allowance* (decision B85): we suggest Transpower still specifies the estimated project cost at P50 (as now), recognising Commission discretion to amend the cost, only if there is robust justification and in consultation with Transpower.
- *Major Capex approvals including NTS* (decision B95): we have proposed amendments to schedule G and Schedule I to better reflect (in our view) new policy for staged major capex, and a more flexible role for non-transmission solutions.
- *Base capex stakeholder engagement and demand forecasting* (decision B106): the draft determination has no drafting to reflect the proposed policy because the Commission intends to amend Information Disclosure regulation. We will respond to this matter when the Commission consults on its proposed amendments to our Information Disclosure regulation.

Next step - review of draft final determination

The Commission has maintained momentum to deliver a comprehensive review to a tight timeframe, so that final decisions can be implemented in time for RCP3.

The Capex IM affects many aspects of our business for up to seven years. Accordingly, we request at least a two-week window to undertake a formal technical assessment of the draft final determination, following the Commission's final decisions indicated for March 2018 on its website.

We continue to be available to discuss any queries and assess drafting to ensure the Capex IM is practicable and gives effect to the final policy decisions.

Yours sincerely



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Appendix A: Mark-up of Capex IM draft determination

Attached.