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20 April 2017

Joseph Highet
Senior Analyst
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Wellington

By email: im.review@comcom.govt.nz

Dear Joseph

Transpower Incremental Rolling Incentive Scheme

We appreciate the opportunity to submit to the Commerce Commission's review draft decision, published 24 March on the incremental rolling incentive scheme (IRIS) that applies to Transpower.

In this submission, we:

1. Comment briefly on the background to this issue
2. Provide support for the Commission's draft decision.

Draft decision to improve the operation of IRIS provisions is welcome

Transpower strongly supports the form of incentive regulation applied by the Commission, which we consider promotes the purpose of Part 4 of the Commerce Act.

Refinements to the Transpower IRIS in the November 2014 Determination required the Commission to exercise administrative judgement when determining the level of temporary cost factors (a key input to the IRIS formulae). A consequence of this change was to reduce Transpower's ability to estimate the financial outcomes for Transpower (and consumers) of efficiency enhancing investments.

This estimation problem created uncertainty and the potential for materially incorrect outcomes. We have signalled our concern to the Commission that this uncertainty and inability to robustly estimate payback on efficiency investments could dilute incentives to efficiently reduce operating expenditure.

We appreciate the Commission's attention on this matter. Identifying a mechanistic solution that consistently produced targeted sharing ratios has been vexing for Transpower and the Commission. We acknowledge efforts by the Commission in this area, including modelling and scenario analysis to better understand the size of potential errors and to test different solutions.

We support the draft decisions on the two issues presented in the consultation paper

We support the draft decisions on (1) the interaction between the IRIS and the Individual Price Path (IPP) forecast and (2) the proposed approach for determining the baseline adjustment term. We outline our views on each proposal below.

1. Interaction between the IRIS and the IPP forecast

Transpower IPP forecasts are developed in Year 3 of the previous regulatory period, not year 4 as previously understood by the Commission, so the forecast does not incorporate any Year 4 savings. The Commission's proposal is to adjust the IRIS mechanism so that it removes the assumption that the IPP forecast incorporates permanent savings in year 4.

We agree with the Commission's proposal to adopt its Option 2, to amend the IRIS mechanism so that it no longer assumes that the IPP forecast incorporates permanent savings in year 4.

2. Proposed approach to determining the baseline adjustment term:

The Commission proposes to "provide further information and guidance on how we intend to estimate the value of temporary savings required for the baseline adjustment term".[1]

We agree with the approach and consider it will allow us to develop processes and analyses that will help minimise the errors the paper refers to. For example, for the Year *1 back cast method*, we will focus our efforts on providing the Commission with good estimates of the one-off factors in Year 1 of RCP3 and of the local trend between Year 3 of RCP2 and Year 1 of RCP3.

Finally, we support the Commission's suggestion of using either or both of their proposed approaches[2] to estimate temporary savings in Year 3 of the second Regulatory Control Period (RCP2), depending on the context of the IPP forecast.

Please let me know if you have any questions or would like to discuss this submission.

Yours sincerely

Jeremy Cain
Regulatory Affairs & Pricing Manager

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[1] Consultation paper 24 March 2017 *Input methodologies review draft decision Transpower Incremental Rolling Incentive Scheme* http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/transpower-iris-provisions/

[2] Called method 1 and method 2 in the consultation paper