



7th November 2014

Dane Gunnell
Senior Analyst
Regulation Branch
Commerce Commission
Wellington

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

Dear Dane

Submission on proposed *Listed Projects* mechanism under Transpower Input Methodologies

We appreciate the opportunity to comment on the proposed amendments to the Transpower input methodologies (including the Capex input methodology). The amendments are to provide for a mechanism for Transpower to apply for, and the Commission to approve, additional base capex for inclusion within RCP2 (the *listed projects* mechanism).

We have a number of comments in regard to the Listed Projects framework and some detailed drafting comments. Our more general comments are included in sections below and our detailed comments are included in Appendix 1.

Listed Projects

We support the proposal to introduce a listed projects framework and agree with the list for RCP2, being those projects listed in Schedule I of the Transpower Individual Price-Quality Path Draft Determination 2015 [2014] NZCC XX, dated 12 September 2014, as shown below:

Schedule I: Listed projects

Line Name (Section)	Estimated Cost	
	RCP2 Cost (\$m)	Project Total Cost RCP2 and later (\$m)
BPE-WIL A (WIL-JFD section)	49	49
OTB-HAY A (Churton Park Section 45A-68)	28	28
CPK-WIL B (Full)	26	26
BRK-SFD B (Full)	11	65
BPE-WIL A (BPE-JFD section)	4	107
Total estimated cost	118	275

While we understand why the Commission may wish to include indicative costs with the project list these should, for the avoidance of doubt, be viewed as highly uncertain.

Listed Project framework should not only be for RCP2

We are disappointed that the Listed Project mechanism appears to be only for RCP2.

The reason we originally raised this issue with the Commission was twofold:

- Despite the Commission's preference for predictability of transmission costs/charges for consumers, there will always be things that change during a Regulatory Control Period and which it is in the interests of consumers that we plan for. Where these are not major capex we need a mechanism to apply for additional base capex.
- Some other projects, including reconductoring projects, generation driven projects and projects driven by step changes in demand, may be relatively large projects but their timing need and cost is uncertain. The effects of this uncertainty do not fit well with the base capex model even despite the substitutability of base capex.

Neither of these reasons will change once RCP3 is upon us. They are inherent and will still exist even when our planning approaches have improved and meet the Commission's expectations.

We understand the Commission's belief that consumers have a preference for predictable transmission costs/charges. The flipside to predictability, however, is flexibility to change our plans as circumstances change. The Commission also wants to deliver minimum (whole-of-life) cost transmission to consumers and that suggests not making expenditure decisions until the last minute to ensure we are making the right decision. Balancing predictability and minimising costs is difficult. While we think the Commission's 5 year regulatory control periods strike a good balance for a significant portion of our routine expenditure, in our view, it does not for some of our larger base capex projects.

As an example, for reconductoring projects:

- determining when a conductor has reached its "end of life", is difficult. We base our judgements on sampling the conductor and the further out from reconductoring we have to make that decision, the more uncertainty there is in the replacement need date.
- determining what to reductor with, requires forecasts of future demand. Again, the further out from reconductoring we have to make that decision, the less likely we will choose the most optimal replacement.
- the cost of reconductoring projects is uncertain and can only be determined to a reasonable level of accuracy with detailed design.

Take for example the Bunnythorpe-Wilton A line (WIL-JFD section). Without a listed project regime, we would need to decide on our course of action perhaps 8 years out. Putting aside the possibility we may choose a more expensive conductor than necessary, if we were to do testing nearer to the planned replacement, we may be able to defer the replacement. Even a 2 year deferral would be a \$6m saving.

While we have only identified a set of reconductoring projects in RCP2, it is possible other projects will emerge related to other drivers. We believe consumers are best served by allowing flexibility to accommodate changes in limited circumstances and that the Listed Project mechanism should provide that flexibility. Failure to do so may lead Transpower to assume high costs and early delivery.

Governance

The proposed amendment to Part 3, subpart 2 of the Transpower Capex IM Determination, by insertion of clause 3.2.4 is largely reasonable, but 3.2.4 (2) (h) is problematic.

That clause requires a listed project application to include evidence that Transpower's Board has approved the listed project and has delegated financial authority to commence the project subject only to Commission approval.

Clause 3.2.4 (5) then goes on to say that the Commission "...may in addition...at its discretion, determine an approved amount of base capex in respect of a listed project...".

Our interpretation of this is that, unlike for major capex projects, where the Commission only have the power to approve or reject Transpower's proposal, for listed projects the Commission may also determine the maximum approval amount.

This is a basic governance issue for Transpower because it means that the Commission may reduce the amount of contingency on a project and Transpower would then be bound by that. It could expose Transpower to unmanageable risk.

We need the ability to review our position should the Commission change the maximum amount recoverable for a listed project. We cannot think of any good reason why listed projects should be different to major capex projects in this regard.

Inefficient boundary issues


We note that the proposed wording limits the listed project mechanism to apply in RCP2 only. We have discussed reasons above why we believe this is not in the interests of consumers, but note here that this would also create unnecessary and inefficient boundary issues between RCP2 and RCP3. It is not clear what cost recovery mechanisms apply to listed projects which are not commissioned within RCP2 ie they are begun in RCP2 but commissioned in RCP3.

The Schedule I projects include two such projects and given the length of our planning and construction processes, it is possible that some of the other projects will also be started in RCP2 and completed in RCP3.

We believe that approved listed projects should be treated like major capex projects from this point of view and should be largely independent of regulatory control period boundaries.

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 1 - Other detailed comments on draft wording

Clause	Wording	Transpower comment
Part 1 – General Matters 5.1 (b)	<i>“in the regulatory period commencing on 1 April 2015 and ending on 31 March 2020, the revenue impact...”</i>	We recommend the addition of a definition of “RCP2” to the Transpower IM (which already includes a definition for RCP1) so this string of words can be simplified.
6.3	<i>“Transpower IMs means the <i>Transpower Input Methodologies Determination</i> [2012] NZCC 17;”.</i>	This definition appears to be superfluous and is not used.
6.4 “3.2.4 (1)”	<i>“the regulatory period commencing on 1 April 2015 and expiring on 31 March 2020, an application...”</i>	See comment for Part 1 – General Matters 5.1 (b)
6.4 “3.2.4 (2)(g)”	<i>“evidence of consultation with interested persons in accordance with clause 3.1.2 (b);”</i>	We note that clause 3.1.2 (b) requires that consultation be “...undertaken by Transpower acting in accordance with the policies and processes specified in its base capex proposal ...”. Is this the appropriate reference?
6.4 “3.2.4 (2)(h)”	<i>“...fully completed “Business Case 3” (BC3) quality assurance checklist...”</i>	Such a reference to a specific internal Transpower document is not appropriate as we revise our internal policies and documents from time-to-time. The “BC3” document no longer exists, for instance. The improved version is called a “Delivery Business Case” internally. Suggest deleting the words “... Transpower’s fully completed “Business Case” (BC3)...” and replacing with “...a...”.
6.4 “3.2.4 (3)”	<i>“(3) For the purposes of subclause (2)(f), a cost-benefit analysis is one that reflects the efficient costs that a prudent supplier of electricity transmission services would require to: “(a) meet or manage the expected demand for electricity transmission services, at appropriate service standards, during the regulatory period commencing on 1 April 2015 and expiring on 31 March 2020 and over the longer term; and “(b) comply with applicable regulatory obligations associated with those services.</i>	We do not understand the relationship between this cost-benefit analysis definition and that described in the Capex IM for using the Investment Test. We consider the policy for the cost benefit analysis for base capex greater than \$20 M at rule 3.2.1 I is the appropriate reference. We suggest deleting this wording and referring to clause 3.2.1.

6.4 "3.2.4 (4)"	"...Transpower to comply with."	Suggest adding the words "...the request." To the end of this sentence.
6.4 "3.2.4 (5)(b)"	"...identified programmeand..."	Insert space after the word programme.
6.4 "3.2.4 (6)"	"...the approved base capex in respect of the listed project will be specified by the Commission through amendment to the IPP determination. "	There may be a logic problem with this wording. Clause 6.2 defines adjusted base capex allowance as base capex plus additional approved base capex in respect of listed projects . If the IPP amendment will be to increment the base capex allowance then there may be double-counting of the listed project base capex through the operation of the amended definition of adjusted base capex allowance , which assumes the base capex allowance in the IPP excludes listed project base capex .