



TRANSPOWER

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Alex Sim
Chief Adviser
Commerce Commission
PO Box 2351
WELLINGTON

Dear Alex

Re: Input Methodologies Discussion Paper and Transpower Process and Recommendation Discussion Paper, both published June 2009

Transpower New Zealand Limited (Transpower) welcomes the opportunity to make a submission in response to the above discussion papers.

Our submission responds to the specific questions raised by the Commission but focuses mainly on those matters that directly relate to Transpower.

Transpower agrees with the Commission's preliminary view that it should recommend to the Minister of Commerce that Transpower be subject to individual price-quality path regulation and that this regulation should take the form of an incentivised total revenue cap developed using a building blocks analysis. In some respects this is a more onerous form of regulation for Transpower than default/customised price-quality regulation, but it is better attuned to the particular characteristics of the transmission business, such as large economies of scale, the consequent lumpiness of investments, lengthy investment cycles with large amplitudes, long investment lead times and substantial attendant forecasting uncertainties.

As the Commission notes, the introduction of a revenue cap framework will also align New Zealand much more closely with the regulatory frameworks applied in other comparable jurisdictions, in particular, Australia and the United Kingdom. This should enable New Zealand to benefit from practical experience gained in those other jurisdictions. We note that some of the Commission's proposals differ from established best practice overseas, but appreciate that this variance is often for pragmatic reasons relating to the history of the regulatory regime in New Zealand and Transpower's immediate operating environment.

The Commission appears sympathetic to Transpower's own suggestion that, at least for the initial period, some elements of Transpower's expenditure may need to be subject to an ex post review at the end of the regulatory period. To limit uncertainty and risk, for both consumers and Transpower, it will be important to ensure that the process by which "ex post prudence" is determined by the Commission is clearly defined within the input methodologies.

The Commission introduces the UK's use of Menu Regulation in its review of OFGEM's regime and explains how this provides a mechanism by which regulators and regulated companies may strike an efficient balance between risk and the sharing of efficiency gains. The Commission further suggests that it may be appropriate to introduce a similar mechanism "once Transpower's capital expenditure forecasting has been developed further".

This is an important signal that the regime set out in the Discussion Paper is transitional and that, once Transpower has demonstrated the robustness of its internal processes, the Commission will consider developing the regime further to allow a more straightforward application of incentives by eliminating the need for ex post reviews entirely. This development will allow Transpower to run its business for the medium term without the risk of regulatory clawback and with the certainty of full cost recovery for prudent and efficient investment.

Transpower generally agrees with the Commission's proposed broad framework for establishing the cost of capital but, as noted in its submission, has concerns about the proposed approach to determining a theoretical cost of debt. More generally we believe that the guidelines could be strengthened to provide greater certainty with respect to the specific approach that the Commission will use to establish the range of input parameters for each industry.

Transpower's experience when developing its administrative settlement with the Commission is that the process and criteria for determining the ex ante allowances for operating and capital expenditure under a building blocks approach have a critical impact on the overall allowed expenditure. Consequently, Transpower considers it essential that the approaches used to forecast operating and capital expenditures, and the precise details of any related incentive arrangements, should be determined early on in the process and prior to the Commission's recommendation to the Minister.

Finally, Transpower acknowledges that the Commission has a significant programme of work ahead in order to achieve milestones needed to implement the Part 4 framework. Engagement between the industry and the Commission throughout this process will help to build the relationships and regulatory certainty needed to achieve the outcomes set out in the Part 4 purpose statement.

Thank you for the opportunity to make this submission. If you have any questions relating to the submission, please contact me.

Yours sincerely



Richard Fletcher
Regulatory Strategy Manager