

TRANSPower





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## **TRANSPOWER STATEMENT OF CORPORATE INTENT ("SCI") FOR 1 JULY 2009 TO 30 JUNE 2012**

### **Introduction**

This SCI is submitted by the Board of Directors of Transpower New Zealand Limited, in accordance with Section 14 of the State-Owned Enterprises Act 1986 ("The Act"). It sets out the Board's overall intentions and objectives for Transpower New Zealand Limited and its subsidiary companies (the Transpower Group)<sup>1</sup> for the year commencing 1 July 2009 and the following two financial years.

Transpower New Zealand Limited and its subsidiary companies are referred to as "Transpower" throughout this SCI.

### **Business scope**

Transpower is the owner and operator of the National Grid, which facilitates electricity transmission and provides co-ordination functions essential to the secure and efficient operation of the national power system. Transpower is contracted by the Electricity Commission (EC) to provide System Operator services to the electricity industry. System operation involves the real-time co-ordination of electricity generation, transmission and demand, and the real-time management of the electricity market in New Zealand.

### **Role of the National Grid**

The National Grid is fundamental to enabling New Zealand to achieve its international and local aspirations. It is vital infrastructure of critical importance to all New Zealanders. New Zealand needs a reliable supply of electricity, delivered to areas of demand, in order to:

- sustain commercial confidence;
- enable economic growth and development;
- enable New Zealand to effectively participate and be competitive in the global community; and
- maintain and enhance the living standards of all New Zealanders.

The National Grid is ageing and requires major upgrading. In addition, the pattern of continuing growth in demand for electricity increases the requirement for transmission capacity, which must be catered for efficiently.

Moreover, Transpower is investigating the transmission implications of the continuing growth in the use of renewable generation which will require the National Grid to link to an increased geographical diversity of generation sites. This may require further enhancement: to grid capacity and extent; and to the capability of the System Operator, in order to manage an increasingly complex power system.

Transpower is committed to playing its part by discharging its responsibilities fully in this regard. Critical to fulfilling this objective is the regulatory regime in which Transpower operates.

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<sup>1</sup> The companies that comprise the Transpower Group are listed in Appendix 3

## Regulatory framework for transmission services

Transpower is subject to regulation under:

- the Commerce Commission in respect of:
  - the quantum of Transpower's revenues to ensure that transmission services are provided efficiently and in a manner that avoids excessive (i.e. monopoly) profits; and
  - the quality with which these services are provided to ensure that they appropriately reflect customers' needs.
- the Electricity Commission in respect of:
  - transmission investment approvals requested by Transpower to ensure security of supply is maintained;
  - agreements and rules to define the nature of transmission services to be provided by Transpower; and
  - the allocation of the costs of transmission services, including new investment costs, between National Grid users (i.e. the transmission pricing methodology).

Transpower believes that there is significant potential for improvements in the regulatory regime, to reinforce Transpower's role as grid planner and the Electricity Commission's as reviewer and approver and to streamline the processes for approval of lower cost investment projects. Transpower will continue to engage with the Electricity Commission (EC), as well as other stakeholders, to achieve this.

## Corporate Social Responsibility

Transpower's prime corporate social responsibility is to provide a reliable transmission service while working in partnership with communities to plan, deliver, and operate infrastructure in a manner which seeks to mitigate the social and environmental impacts of Transpower's activities.

Transpower's approach to corporate social responsibility is to look at our actions through the eyes of our stakeholders – engaging with communities, landowners, customers, employees, and shareholders - and use their expectations to identify how to improve our performance.

Transpower has established performance targets and reporting frameworks to demonstrate how these responsibilities are reflected in Transpower's functions and actions.

## Context for the 2009/10 SCI

Transpower's priority over the next three years is to deliver key projects necessary to reinforce the national grid, while continuing to invest in technological solutions to increase utilisation of the grid assets.

There is the need for increased investment in both new capacity and in asset refurbishment and replacement, to address the legacy of a sustained period of low investment.

As Transpower completes its transition from a prolonged period of relatively low investment to a sustained period of high investment, the following key factors and influences should be noted:

- Capital investment is planned to increase sharply driven principally by the three major upgrade projects (the North Island Grid Upgrade between Whakamaru and South Auckland; a new High Voltage Direct Current Pole (Pole 3) to replace the existing Pole 1; and the North Auckland and Northland Project reinforcing supply through Auckland CBD to the north).

- Further increases in capital investment, together with enhanced asset management strategies, are focused on ensuring that Transpower's asset management regime is robust and fit for purpose, in accordance with good electricity industry practice. Projected total capital expenditure including all upgrade and asset renewal works is set out in Section C, below.
- The nature of transmission investment means that in the short term, before the current reinforcement programme takes effect, unplanned systems interruptions may exceed the SCI measure. Details of all the operational performance measures are set out in Section E.
- The conditions in international credit markets are unlikely to restrict Transpower's access to capital necessary to fund its investment programme. However, the cost of funds has increased markedly. To ensure continued access to capital and minimise the cost of funds, preservation of a sound credit rating (currently AA minus) is a priority. The suspension of dividend payments to the Crown is a key part of Transpower's capital management during this period of heavy investment, refer Section F.
- The nature of the regulatory regime for transmission is a crucial influence on Transpower's overall performance.
- Transpower's financial results are likely to be impacted by the significantly increased costs of instantaneous reserves allocated to the HVDC link. Transpower's current financial exposure to high HVDC reserves costs will continue until the new HVDC Pole 3 is commissioned, or the regulatory agencies allow recovery from industry participants.
- Transpower is not currently active in exploring opportunities for developing further its non-core, unregulated activities. This is to allow the focus of the Board and management to be directed fully on the significant challenges of renewing and enhancing the National Grid, its System Operator functions and their associated supporting technologies.
- Opportunities for Transpower to add economic value (i.e. achieve returns in excess of its cost of capital) are very restricted. The regulatory framework within which Transpower operates will, over time, limit Transpower's return on capital invested from regulated assets to no more than Transpower's estimated cost of capital and risks to economic value are weighted currently toward the downside. Economic returns measured on an annual basis will also be affected by material inter-temporal adjustments. Upside opportunities will occur predominantly from investment in unregulated activities.

## **A TRANSPOWER'S OBJECTIVES**

Transpower's principal objective, as set out in Section 4 of the Act, is to operate as a successful business and to be:

- a) as profitable and efficient as comparable businesses that are not owned by the Crown;
- b) a good employer; and
- c) an organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so.

To achieve its principal objective, Transpower will:

- a) be as profitable and efficient as comparable businesses:
  - within regulatory requirements seek to deliver and operate a National Grid that meets the needs of users now and into the future;
  - comply with the statutory requirements of the regulatory regimes under which it operates;
  - work with regulatory agencies to agree investment plans that address risks to power system reliability or that relieve persistent congestion affecting market efficiency;
  - provide transmission services at the standard of quality and security agreed with National Grid users or required by regulatory agencies;
  - provide System Operator services in accordance with service agreements negotiated with users of those services or required by regulatory agencies;
  - promote efficient investment in the National Grid to provide the platform for a competitive wholesale market thus enabling options for investment in generation and demand-side management;
  - seek to efficiently recover the full costs of its services;
  - improve the efficiency of its services, whilst optimising asset reliability and availability; and
  - pursue business opportunities based on the capabilities and expertise developed through its core business activities.
- b) be a good employer:
  - maintain well qualified and motivated staff and adopt human resource policies that treat employees fairly and properly in all aspects of recruitment, retention and employment; and
  - promote a high level of safety throughout the organisation, taking all practicable steps to provide its employees and the employees of its contractors with safe working conditions.
- c) act in a socially responsible manner:
  - build closer relationships with landowners, occupiers and other community representatives and interest groups affected by Transpower's activities;
  - build closer relationships with Maori;

- improve environmental reporting and performance, taking all reasonable steps to reduce the risk of adverse effects on the environment that may be caused by aspects of Transpower's activities;
- incorporate sustainability into Transpower's business activities and work with key stakeholders to promote sustainable outcomes for the electricity sector; and
- sponsor educational and training activities that support the future requirements of the electricity industry in New Zealand.

## B NATURE AND SCOPE OF COMMERCIAL ACTIVITIES

Transpower's principal commercial activities are:

- the transmission of electrical energy from producers to distributors and direct supply users;
- the operation, maintenance and development of such assets as are required to seek to ensure this is achieved on a long term basis;
- as System Operator, the short term matching of demand and supply of electricity;
- the co-ordination of the provision of ancillary services, including voltage control and frequency control; and
- the gathering, management and provision of information to the electricity industry.

Any significant departure from Transpower's principal business activities and/or any proposal that Transpower should enter into significant new business activities will be discussed in advance with the Shareholding Ministers. Approval will normally be sought through the Shareholding Ministers' consideration of updated Statements of Corporate Intent.

## C CAPITAL STRUCTURE AND INVESTMENT

The estimated capital structure at 2008/09 year-end, and forecast for the next three financial years is set out below:

<b>Capital Structure and Investment<sup>2</sup></b>	<b>2008/09 Forecast</b>	<b>2009/10</b>	<b>2010/11</b>	<b>2011/12</b>
Debt (\$ million)	1,235	1,406	1,912	2,277
Equity (\$ million)	1,371	1,532	1,725	1,973
Total Funds Employed (\$ million)	2,905	3,329	4,089	4,759
Ratio of Equity to Total Funds	0.47	0.46	0.42	0.41
Capital Investment (\$ million)	353	571	898	848

*\*Note: See Appendix 1 for definition of capital structure and investment*

<sup>2</sup> The figures in this table are expressed on the basis of New Zealand International Financial Reporting Standards (IFRS) in accordance with Transpower's Accounting policy.

Transpower's intent is that investment related expenditures can be fully recovered from transmission customers in a timely manner. However, cost recovery is subject to regulatory decisions by the Electricity Commission and Commerce Commission.

Transpower will aim to optimise its capital structure. Optimisation depends on a number of factors, including long-run expectations for: the economic environment; Transpower's weighted-average cost of capital; the security of Transpower's revenue stream; and required spending on National Grid assets.

Significant additional capital funding will be required as major investments are undertaken to reinforce the National Grid. Investment of this magnitude will place significant pressure on Transpower's balance sheet. The investment outlook, and the need to maintain access to appropriate debt markets to allow efficient debt funding for necessary capital investments, are reflected in the Directors' view that the AA band is the appropriate range for Transpower's credit rating.

This view is reinforced by the effects of the global financial crisis on both the availability and cost of debt funding. These effects are expected to continue for some time. With Transpower's funding requirements expected to increase significantly over the next three years, maintaining a strong credit rating is important to ensure sufficient access to efficient debt funding.

Transpower will seek to manage its future capital requirements without recourse to additional equity injection by the shareholder. To achieve this and maintain an appropriate credit rating will require a higher proportion of retained funds (refer Section F, below).

Prudent liquidity management policies, consistent with Transpower's credit rating, are in place to ensure that sufficient funding is secured ahead of need, and to provide protection against any unexpected deterioration in credit markets.

## **D ACCOUNTING POLICIES**

The accounting policies recognised by the New Zealand Institute of Chartered Accountants for the measurement and reporting of profit, cash flow, movements in equity, and financial position have been adopted by Transpower.

Details of Transpower's accounting policies and their application are specified in Appendix 4.

## **E PERFORMANCE TARGETS AND MEASURES**

The performance of Transpower in relation to its objectives (contingent on resolution of the current uncertain regulatory framework) will be assessed by reference to a range of operational, financial and non-financial performance targets, grouped by principal objective. These targets are set out below.

For reference, a comparison of the performance targets and measures for the 2009/10 year set in the 2008/09 SCI with those set in the 2009/10 SCI is contained in Appendix 2.

- a) To be as profitable and efficient as comparable businesses

<b>Operational Performance Targets</b>	<b>2008/09 Forecast</b>	<b>2009/10</b>	<b>2010/11</b>	<b>2011/12</b>
High Voltage Alternating Current (HVAC) availability (%)	98.5	98.3	98.3	98.3
High Voltage Direct Current (HVDC) (pole 2 only) availability (%)	97.1	97.3	97.3	97.3
Unplanned supply interruptions (System Minutes)	16.9	< 9.0	< 9.0	< 9.0

<b>Financial Performance Targets</b>	<b>2008/09 Forecast</b>	<b>2009/10 Budget</b>	<b>2010/11 Plan</b>	<b>2011/12 Plan</b>
Operating profit margin	57.7%	61.5%	64.0%	68.3%
Interest coverage	4.4	4.2	3.6	3.7
Return on capital employed	7.5% <sup>3</sup>	7.9% <sup>3</sup>	8.3%	8.2%
Return on equity	10.1%	10.8%	11.5%	13.1%
Average total transmission costs (c/kWh)	1.56	1.61	1.74	2.01
Estimated economic value added (\$million)	(37)	(11)	19	30

<b>Non-Financial Performance Targets</b>	<b>2008/09 Forecast</b>	<b>2009/10 Budget</b>	<b>2010/11 Plan</b>	<b>2011/12 Plan</b>
Material Breaches of System Operator Performance Obligations reported to the Electricity Commission	2	<15	<15	<15

*\*Note See Appendix 1 for definition of performance measures*

<sup>3</sup> Includes the one-off revenue for the termination of the Cross Border Leases.

b) To be a good employer

<b>Non-Financial Performance Targets</b>	<b>2008/09 Forecast</b>	<b>2009/10 Budget</b>	<b>2010/11 Plan</b>	<b>2011/12 Plan</b>
ACC Workplace Safety Audit Status	Tertiary	Tertiary	Tertiary	Tertiary
Lost Time Injury Frequency Rate (per million hours)	1.5	1.3	1.0	1.0
Lost Time Injury Severity Rate (per million hours)	78.3	35	30	25

*\*Note: See Appendix 1 for definition of performance measures*

## (c) To be an organisation that exhibits a sense of social responsibility

<b>Corporate Social Responsibility</b>		
	<b>Target</b>	<b>2009/10 Proposed Actions</b>
<b>Infrastructure</b>	Establish a programme to achieve sustainable reductions in the number of unplanned interruptions to supply and to improve the measurement and reporting of supply performance.	Develop asset strategies for other main components of the grid asset fleet. Implement a behavioural change programme aimed at reducing operational errors. Develop the scope for, and seek Board approval to, implement a replacement Asset Management System.
<b>Environmental care</b>	Establish Environmental Management System.	Initiate systematic work programmes to secure environmental performance improvement, including improved consent compliance and greenhouse gas management.
	Establish a policy on under-grounding of new transmission lines in urban areas or areas of significant heritage value.	Review economic and operational implications of draft policy, elicit stakeholder feedback and secure Board approval.
	Identify encroachments within transmission corridors and develop action plans to address issues identified.	Continued activity in the following areas: <ul style="list-style-type: none"> <li>▪ Submitting on resource consent applications for development within transmission corridors</li> <li>▪ Seeking buffer distances through NPS and development of an NES</li> <li>▪ Line surveying to identify proactively and rectify non-compliant structures and other encroachment</li> </ul>
<b>Communities</b>	Establish a procedure and targets for implementing Transpower's "Commitment to Consultation" policy, engaging with communities on a project-by-project basis.	Regional planning forums extended to Bay of Plenty and Waikato regions. Stakeholder engagement forums held for all significant (>\$20m) grid upgrade proposals. APR developed with stakeholder input to identify medium-term regional grid development outcomes.
	Meet annual targets set in Transpower's Community Care Fund.	Align grants more closely with upcoming Transpower projects to target affected communities.
<b>Climate change</b>	Report total direct and indirect green house gas emissions against management and mitigation targets set out in Transpower's GHG management programme.	2008/09 report published on Transpower's website. Complete review of SF6 gas handling/management procedures.
	Include plans to support development of renewable generation in the 2009 APR.	Commence stakeholder engagement on options to support development of Lower North Island renewables. Submit and consult on proposals for Lower South Island renewables.
<b>Landowners</b>	Consult with landowners directly affected by Transpower's operations to establish a set of targets and work programmes for improving our relationship with landowners.	Conduct benchmarking research with landowners affected by transmission assets. Review and update policy to guide the approach to landowners for access to Transpower assets.
<b>Customers</b>	Develop targets for responding to customer concerns and enquiries over Transpower performance.	Reliability of supply to consumers enhanced through Connection Risk Management initiative. Implement revised New Investment Contract.
	Year on year improvement in surveyed rating of customer satisfaction.	Target of 3% improvement in overall customer satisfaction compared with 2008/09 result.

## F DIVIDEND POLICY AND ESTIMATES

Funds attributable to the shareholder and surplus to Transpower's financing and operating requirements will be distributed annually to Transpower's shareholders.

The level of surplus funds each year will be determined by reference to a sustainable financial structure, having regard to: Transpower's credit rating; predictions of short and medium term economic conditions; the medium term capital expenditure programme; and working capital requirements.

Given the extensive investments planned in asset upgrade and renewal, and an assumption of no further equity injection, it is anticipated that no dividend payments will be made over the forecast period.

Year	2008/09 Forecast	2009/10 Budget	2010/11 Plan	2011/12 Plan
Estimated amount to be distributed by dividend	nil	nil	nil	nil

In recommending the dividends to be paid to shareholders, Transpower will follow procedures generally adopted by Directors of publicly listed companies, and comply with the requirements of section 15 of the Act and any notice given by the Shareholding Ministers under section 13 of the Act.

## G INFORMATION TO BE REPORTED

To enable the Shareholding Ministers to assess the value of their investment in Transpower, any information that would normally be supplied to a controlling private shareholder will be made available.

An annual report for each financial year, including audited financial statements, will be submitted in accordance with section 15 of the Act. The annual report will:

- contain sufficient information to enable an informed assessment to be made of Transpower's operations, including a comparison with the SCI; and
- state the dividend payable to the Crown for the relevant financial year.

Transpower will also submit the following information to the Shareholding Ministers:

- half-yearly reports in accordance with section 16 of the Act, which will include unaudited profit and loss, balance sheet and cash flow statements together with such details as are necessary to permit an informed assessment of the company's performance during that reporting period; and
- a draft of Transpower's Business Plan and a draft SCI, which will be made available to Shareholding Ministers for discussion prior to the commencement of the financial year to which the plan and the SCI relates.

Transpower will, in addition, provide other information relating to the affairs of the company requested by the Shareholding Ministers pursuant to section 18 of the Act.

## **H PROCEDURES FOR SHARE SUBSCRIPTIONS OR PURCHASES**

Subscriptions for shares in any company or interests in any other organisation will, where material, be subject to consultation with Shareholding Ministers. The procedures for the establishment of subsidiary companies and the sale of substantial assets in Transpower or any of its subsidiaries are set out in Appendix 3.

## **I ACTIVITIES FOR WHICH COMPENSATION IS SOUGHT**

Transpower will, in accordance with section 7 of the Act, seek compensation sufficient to allow Transpower's position to be restored if the Government wishes Transpower to undertake activities or assume obligations that in Transpower's view will:

- result in a reduction of Transpower's profit or net worth; or
- modify the National Grid in ways which lower its ongoing security and reliability.

There are currently no activities in relation to which Transpower is seeking, or has sought, compensation from the Crown.

## **J OTHER MATTERS AGREED BY THE SHAREHOLDING MINISTERS AND THE BOARD**

No other matters have been agreed by the Shareholding Ministers and the Board for inclusion in this statement pursuant to section 14(2) (j) of the Act.

## **K COMMERCIAL VALUE OF THE CROWN'S INVESTMENT**

As at 30 June 2009, the principal physical assets of Transpower primarily comprise:

- 179 sub/switching stations;
- more than 11,806 route kilometres of HVAC and HVDC transmission lines;
- the HVDC link between the North and South Islands;
- two national control centres;
- three regional operating centres;
- a communications network;
- a supervisory control and data acquisition network;
- 79 freehold properties acquired on the proposed route for the North Island Grid Upgrade.

In addition the company has significant intellectual capital in staff, company processes and procedures.

The Board's estimate of the current commercial value of the Crown's investment in Transpower at 1 July 2009 is \$1.25 billion. This estimate is materially the same as the reported shareholders' funds as disclosed in the unaudited interim financial statements as at 31 December 2008.

This assessment of value reflects the predominantly regulated nature of Transpower's activities. The regulatory framework within which Transpower operates sets a regulated return on capital employed for the regulated asset base. This return is set based on parameters agreed with the Commerce Commission and reflects an assessment of Transpower's weighted-average cost of capital (WACC), over the five-year term of the Administrative Settlement (to 30 June 2011).

The Board considers that Transpower's balance sheet ("book value") provides a materially accurate assessment of the company's commercial value. This view reflects the fact that Transpower's book value is predominantly comprised of the regulatory value of its transmission assets. The company expects to realise this value over time through receipt of corresponding regulated cash flows.

Previous independent assessment of corporate valuation (based on discounted cash flow analysis) has confirmed this assessment.

## APPENDIX 1 DEFINITIONS OF CAPITAL STRUCTURE, INVESTMENT AND PERFORMANCE MEASURES

<b>Capital Structure and Investment</b>	
Debt	"Debt" equals current and non current debt and finance leases
Equity	"Equity" equals share capital, reserves and accumulated retained earnings.
Total Funds Employed	"Total Funds Employed" equals current liabilities, term liabilities and equity.
Ratio of Equity to Total Funds	Equals "Equity" divided by "Total Funds Employed"
Capital Investment	Capital investment equals total capital expenditure, excluding net property acquisitions/disposals

<b>Operational Performance Targets</b>	
High Voltage Alternating Current (HVAC) availability (%)	Number of hours per year that HVAC electricity network or part thereof is in service expressed as a percentage
High Voltage Direct Current (HVDC) (pole 2 only) availability (%)	Number of hours per year that HVDC electricity network or part thereof is in service expressed as a percentage
Unplanned supply interruptions (System Minutes)	<p>A system minute is a standardised unit for measuring interruptions to the power supply from the National Grid. One system minute is equivalent to the loss of total national power supply for one minute. System minutes are calculated by dividing the total amount of energy not supplied to customers because of unplanned outages by the system maximum peak demand. The system maximum demand figure used is 6,635 MW.</p> <p>The target of &lt;9.0 System Minutes for unplanned supply interruptions was set at this level in 2000/01. In addition, under the terms of its Administrative Settlement with the Commerce Commission, Transpower has committed to use "best endeavours" to meet a level of total system minutes (i.e. planned and unplanned supply interruptions) &lt; 8.3. This target was set based on the average number of supply interruptions over the five year period from 1 July 1998 to 30 June 2003.</p>

<b>Financial Performance Targets</b>	
Operating profit margin	Earnings before interest, tax, depreciation and amortisation (EBITDA) divided by total revenue.
Interest coverage	EBITDA less cash tax, divided by interest expense.
Return on capital employed	Earnings before interest and tax (EBIT) less comprehensive tax (adjusted for interest tax shield), divided by average capital employed.
Return on equity	Profit After Tax (excluding fair value movements) divided by equity (adjusted for fair value movements).
Average total transmission costs (c/kWh)	Total Transmission revenue divided by Transpower delivered energy. (kWh).
Operating cost to peak demand (\$000's/MW)	Operating cost to peak demand is the ratio of total regulated transmission operating costs divided by the peak energy demand transmitted during the year.
Estimated economic value added (\$million)	Measures the net profit earned in excess of that required to deliver a return equal to the estimated weighted average cost of capital for Transpower's business activities.

<b>Non-Financial Performance Targets</b>	
Material Breaches of System Operator Performance Obligations reported to the Electricity Commission	Material means breaches that have a market impact exceeding \$20,000
ACC Workplace Safety Audit Status	Result of ACC Workplace Safety Audit
Lost Time Injury Frequency Rate (per million hours)	LTIFR is the number of Lost Time Injuries multiplied by one million divided by the number of hours worked.
Lost Time Injury Severity Rate (per million hours)	LTISR is the number of days off work multiplied by one million divided by the number of hours worked.

## APPENDIX 2 REVIEW OF PERFORMANCE TARGETS AND MEASURES FOR 2009/10

The following tables compare the performance targets and measures for the 2009/10 year set in the 2008/09 SCI with those set in the 2009/10 SCI. Commentary is provided to explain the variances.

*\*Note: See Appendix 1 for definition of performance targets*

<b>2009/10 Operational Performance Targets</b>	<b>2008/09 SCI</b>	<b>2009/10 SCI</b>
High Voltage Alternating Current (HVAC) availability (%)	98.3	98.3
High Voltage Direct Current (HVDC) (pole 2 only) availability (%)	97.3	97.3
Unplanned supply interruptions (System Minutes)	<9.0	<9.0

Forecast Operational Performance Targets have remained the same as in the 2008/09 SCI.

<b>2009/10 Capital Structure and Investment</b>	<b>2008/09 SCI</b>	<b>2009/10 SCI</b>
Debt (\$ million)	1,514	1,406
Equity (\$ million)	1,691	1,532
Total Funds Employed (\$ million)	3,631	3,329
Ratio of Equity to Total Funds	0.47	0.46
Capital Investment (\$ million)	659	571

The lower debt is the result of lower capital expenditure during 2008/09 and, hence, lower borrowing requirements. The lower equity is due to a reduction in net profit after tax for 2008/09, inclusive of the losses recorded to the fair value movement on financial instruments. Reduced profit was also the result of lower than planned transmission revenue and higher instantaneous reserve costs for the HVDC link. This impact flows through to total funds employed. Lower forecast capital investment in 2009/10 is due, primarily, to delays and uncertainty around the timing and outcome of the Board of Inquiry for the North Island Grid Upgrade Project (NIGUP).

<b>2009/10 Financial Performance Targets</b>	<b>2008/09 SCI</b>	<b>2009/10 SCI</b>
Operating profit margin	64.4%	61.5%
Interest coverage	4.0	4.2
Return on capital employed	8.7%	7.9%
Return on equity	12.9%	10.8%
Average total transmission costs (c/kWh)	1.68	1.61

The lower operating profit margin and return on capital employed is due to lower forecast revenue combined with increased instantaneous reserve costs for the HVDC link. The lower operating profit flows through to a lower return on equity and return on capital employed. The

lower average total transmission costs are a reflection of the lower expected transmission revenue.

<b>2009/10 Non-Financial Performance Targets</b>	<b>2008/09 SCI</b>	<b>2009/10 SCI</b>
Material Breaches of System Operator Performance Obligations reported to the Electricity Commission	<15	<15

Forecast compliance with the System Operator's principal performance obligations remains the same as in the 2008/09 SCI.

<b>Non-Financial Performance Targets</b>	<b>2008/09 SCI</b>	<b>2009/10 SCI</b>
ACC Workplace Safety Audit Status	Tertiary	Tertiary
Lost Time Injury Frequency Rate (per million hours)	1.6	1.3
Lost Time Injury Severity Rate (per million hours)	39.0	35.0

Lower targets for safety performance have been set in line with an enhanced focus on driving improved safety awareness and supporting behaviours throughout Transpower's activities.

### APPENDIX 3 SUBSIDIARY COMPANIES

The terms "share", "Shareholding Ministers", and "subsidiary" have the same meanings as in section 2 of the Act.

Transpower will ensure at all times that:

- a) control of the affairs of every subsidiary of Transpower is exercised by a majority of the Directors appointed by Transpower; and
- b) a majority of the Directors of every subsidiary of Transpower are persons who are also Directors or employees of Transpower, or who have been approved by the Shareholding Ministers for appointment as Directors of the subsidiary.

#### *Transpower's current subsidiaries*

The Transpower Group contains the subsidiary companies listed in the table below.

<b>Name</b>	<b>Holding</b>
Fighting Bay Finance Limited	100%
Oteranga Bay Limited	100%
Haywards Limited	100%
Halfway Bush Finance Limited	100%
TB and T Limited	100%
Risk Reinsurance Limited	100%
Transpower Finance Limited	100%
Energy Market Services Limited	100%
d-cyphaTrade Limited	100%
Omaka Training Limited (non-trading)	100%

#### *Functions of subsidiary companies*

Fighting Bay Finance Limited, Oteranga Bay Limited and Haywards Limited were established when Transpower was a subsidiary of the Electricity Corporation of New Zealand. They were used in the mid 1990s to facilitate cross-border leases. These companies do not undertake trading activities. Their purpose is to hold assets on behalf of the Transpower Group.

Halfway Bush Finance Limited and TB and T Limited were formed during the 2003 cross-border lease transaction. These companies do not undertake trading activities. Their purpose is to hold assets on behalf of the Transpower Group.

Risk Reinsurance Limited is Transpower's captive insurance subsidiary. It is the primary insurer on Transpower's material damage and cables insurance programmes (both power and fibre optic). Risk Reinsurance Limited reinsures a portion of this risk with third party insurers. Risk Reinsurance is registered in the Cayman Islands, but is domiciled in New Zealand for taxation.

Transpower Finance Limited is a financing company, arranging Group borrowings and associated interest rate derivatives.

Energy Market Services Limited provides reconciliation and metering services in New Zealand.

d-cyphaTrade Limited markets energy derivative products in association with the Australian Stock Exchange.

Omaka Training Limited is a dormant company.

### *Consultation*

Transpower will, in relation to any single transaction or series of transactions, consult with the Shareholding Ministers on items outside normal operations and having a material impact on Transpower's financial position not contemplated in the Business Plan, including:

1. any substantial capital investment in activities within the scope of core business;
2. any substantial expansion of activities outside the scope of core business;
3. subscription for, or sale of, shares in any company or equity interests in any other organisation which are material, involve significant overseas equity investment or are outside Transpower's core business;
4. the sale or other disposal of the whole or any substantial part of the business undertaking of Transpower; and
5. where Transpower or its subsidiaries hold 20% or more of the shares in any company or other body corporate (not being a subsidiary of Transpower), they will not sell or otherwise dispose of any shares in that company without first giving written notice to the Shareholding Ministers of the intended disposal.

Transpower will also consult on specific items included in the Business Plan as agreed between Transpower and Shareholding Ministers from time to time.

For the purpose of this document, a substantial investment outside core business would be any transaction or series of transactions resulting in a maximum potential cash outflow from Transpower in excess of \$20 million or 2% of total consolidated Transpower group equity, whichever is the lesser.

## APPENDIX 4 STATEMENT OF ACCOUNTING POLICIES

### 1. Reporting Entity and Statutory Base

Transpower New Zealand Limited (Transpower) is a State-Owned Enterprise registered in New Zealand under the Companies Act 1993. The financial statements presented are those of Transpower (the Parent) and its subsidiaries (together the Group).

### 2. Nature of Operations

Transpower is the owner and operator of New Zealand's national electricity grid. Transpower is not a public benefit entity for the purposes of NZ IAS 1 "Presentation of Financial Statements".

### 3. Basis of Preparation

The financial statements have been presented in accordance with the State-Owned Enterprise Act 1986 and are prepared in accordance with the Financial Reporting Act 1993. The Financial Reporting Act 1993 requires compliance with generally accepted accounting practice (GAAP) in New Zealand. In December 2002, the New Zealand Accounting Standards Review Board announced that International Financial Reporting Standards (IFRS) will apply to all New Zealand entities for periods commencing on or after 1 January 2007. New Zealand has adopted its own version of IFRS, being the New Zealand equivalents to IFRS (NZ IFRS). Transpower has adopted NZ IFRS for the period commencing 1 July 2007 and these financial statements have been prepared in compliance with NZ IFRS. In complying with NZ IFRS, Transpower is also in compliance with IFRS. Transition from existing GAAP to NZ IFRS has been made in accordance with NZ IFRS 1 "First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards". Comparative information has been restated to conform to the requirements of NZ IFRS.

### 4. Measurement Basis

The measurement basis adopted in the preparation of these financial statements is historical cost except as modified by certain investments, held for sale assets, investment property, financial assets and financial liabilities as identified in specific accounting policies below.

### 5. Specific Accounting Policies

#### a) Basis of Consolidation

The Transpower Group financial statements consolidate the financial statements of subsidiaries using the purchase method. Subsidiaries are those entities controlled, directly or indirectly, by the Parent. All significant intercompany accounts and transactions are eliminated on consolidation. In the Parent's financial statements, investment in subsidiaries is carried at cost.

#### b) Goodwill

Goodwill, representing the excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired, is recognised as an asset and not amortised, but tested for impairment annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

- c) **Revenue**  
 Transpower recognises revenue as it provides services or delivers products to customers. Two significant streams of revenue that are received up-front but are deferred over the service period are “cross-border lease gains” and certain “new investment agreements”.

New investment agreements are agreements between Transpower and customers regarding the building of certain customer required grid connection assets. New investment agreement revenue is recognised over the contract period. Cross-border lease revenue is recognised over the minimum period in which the cross-border lease applies.

Due to the service periods, in relation to above items, being greater than one year, revenue is shown on a yield to maturity basis gross of an inferred interest expense.

Certain money relating to the operation of the electricity market, specifically non-Transpower related ancillary services and losses and constraint payments, is “passed-through” and is therefore not recorded in the income statement. This pass-through occurs when Transpower does not carry out the service and it is deemed to act only as a collection agent.

- d) **Goods and Services Tax (GST)**  
 The income statement and the cash flow statement are prepared so that all components are stated exclusive of GST. All items in the balance sheet are stated exclusive of GST with the exception of receivables and payables, which include GST.
- e) **Accounts Receivable**  
 Accounts receivable are recorded initially at fair value and subsequently measured at amortised cost using the effective interest rate method, less any provision for doubtful debts.
- f) **Inventories**  
 Stocks of materials are recorded at the lower of cost and net realisable value after due consideration for excess and obsolete items. Cost is determined on a weighted average basis.
- g) **Investments**

*Regular Way Financial Asset Purchases*

All regular way financial asset purchases are accounted for on settlement date and not trade date.

*Investment in subsidiaries*

Investment in subsidiaries is accounted for in accordance with a) above.

*Available for sale*

Fonterra securities are designated as available for sale. This is because the securities are not held for trading, have no maturity date, are not quoted in an active market, and have no fixed or determinable payments.

Fair value is based on the annual price published by Fonterra, which is based on an independent valuation.

*Fair value through profit or loss*

Risk Reinsurance Limited's investments are designated as fair value through profit or loss. This is on the basis that Risk Reinsurance Limited has an active investment programme (held for trading).

All other investments (excluding Fonterra securities, investment in subsidiaries and derivatives) are designated as fair value through profit or loss on the basis of preventing an "accounting mismatch".

Transpower's net debt and derivatives are managed as one integrated portfolio; therefore, measuring derivatives and net debt on different bases would create a recognition inconsistency or accounting mismatch.

Fair values of quoted investments are based on prices current at balance date. If the market for a financial asset is not active, fair value is established by using valuation techniques including recent arm's length transactions, reference to similar instruments, discounted cash flow analysis and option pricing models. Where the fair value of equity instruments cannot be reliably determined, the investments are recorded at historical cost.

- h) **Other Financial Assets at Fair Value through Profit or Loss**  
Other assets at fair value through profit or loss are derivatives. Derivatives are designated as held for trading unless they are designated as hedging instruments in a hedging relationship. Realised and unrealised gains and losses arising from changes in the fair values are included in the income statement in the period in which they arise.
- i) **Loans and Receivables**  
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not traded in an active market. These assets are carried at amortised cost using the effective interest rate method.
- j) **Trade and Other Payables**  
Trade and other payables are carried at amortised cost. They represent liabilities for goods and services provided to Transpower prior to the end of the financial year that are unpaid. Provisions are liabilities of uncertain timing or amount. They are measured at the amounts expected to be paid when the liabilities are settled.
- k) **Available for Sale Financial Assets**  
Available for sale financial assets are non-derivatives that are either designated as available for sale by management or not designated in any of the other categories. These investments are carried at fair value with, any unrealised gains and losses arising from changes in fair value recognised directly in equity. On sale or on impairment, the accumulated fair value adjustments are included in the income statement.
- l) **Property, Plant and Equipment**  
Property, plant and equipment are recognised at cost less accumulated depreciation. Cost is determined by including all costs directly associated with bringing the assets to their location and condition for their intended use.

m) Capital Work in Progress

Capital work in progress is recorded at cost. Cost is determined by including all costs directly associated with bringing the assets to their location and condition. Finance costs incurred during the period of time that is required to complete and prepare the asset for its intended use are capitalised as part of the total cost for capital work in progress. The finance costs capitalised are based on Transpower's weighted average cost of borrowing. Assets are transferred from capital work in progress to property, plant and equipment as they become operational and available for use.

n) Depreciation

Depreciation of property, plant and equipment is calculated using the straight line method to write down the cost of property, plant and equipment to its estimated residual value over its estimated useful life.

The estimated useful lives are as follows:

Transmission lines	20-75 years
Freehold buildings	30-55 years
Substations	8-55 years
HVDC	3-30 years
Communications	3-25 years
Administration assets	3-10 years

o) Non Current Assets Held for Sale

Non current assets (and disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Non current assets (and disposal groups) are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition and is expected to be completed within one year from the date of classification.

p) Investment Property

Investment property is property held primarily to earn rentals and/or capital gain rather than used for operational purposes. Measurement is at fair value at the reporting date. Gains or losses arising from changes in the fair value of investment property are included in the income statement in the period in which they arise.

q) Leased Assets

Transpower is a lessee of certain property, plant and equipment under both finance and operating leases. Transpower is also a lessor of certain property, plant and equipment under operating leases.

Finance leases effectively transfer all of the risks and benefits incidental to ownership to the lessee, being Transpower. Leased assets are depreciated over their useful lives. A corresponding liability is also established at the inception of each lease, and each lease payment is allocated between the liability and finance costs.

Under operating leases, all the risks and benefits of ownership remain with the lessor. Operating lease payments/receipts are representative of the pattern of benefits derived from the leased assets and are accordingly recognised in the income statement as expenses/revenue, in the period in which the benefits are incurred/received.

r) Intangibles

The cost of acquiring an intangible asset is amortised from the date the underlying asset is held ready for use on a straight line basis over the period of its expected benefit, which is as follows:

Software	3-7 years
Easements	Indefinite

Easements are deemed to have an indefinite useful life, as the contracts do not have a maturity date and Transpower expects to use the easements indefinitely. Therefore, easements are not amortised. Their value is assessed annually for impairment, and their carrying value is written down if found impaired. Transpower capitalises the direct costs associated with putting the easements in place. These costs include registration and associated legal costs and also any injurious affection payments. Certain easements have been donated by the Crown. These are recognised at cost (nil) plus any direct cost associated with putting the easement in place.

For intangibles with a finite life, where the periods of expected benefit or recoverable values have diminished due to technological change or market conditions, amortisation is accelerated or the carrying value is written down.

s) Impairment of Assets

At each reporting date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are largely independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Goodwill, intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually and whenever there is an indication that the asset may be impaired. An impairment of goodwill is not subsequently reversed.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in the income statement immediately, unless the relevant asset is carried at fair value, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised in the income statement immediately, unless the relevant asset is carried at fair value, in which case the reversal of the impairment loss is treated as a revaluation increase.

## t) Debt

Debt is designated as fair value through profit or loss on the basis of preventing an “accounting mismatch”. Transpower’s net debt and derivatives are managed as one integrated portfolio; therefore, measuring derivatives and net debt on different bases would create a recognition inconsistency or accounting mismatch.

Fair values of quoted debt are based on prices current at balance date. If the market for a financial liability is not active, fair value is established by using valuation techniques including recent arm’s length transactions, reference to similar instruments and discounted cash flow analysis.

## u) Employee Benefits

Provision is made for benefits accruing to employees when it is probable that settlement will be required and they are capable of being measured reliably.

Provisions made in respect of employee benefits expected to be settled within 12 months, are measured at their nominal values using the rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits that are not expected to be settled within 12 months are measured at the present value of the estimated cash flows to be made by the Group in respect of services provided by employees up to reporting date.

*Defined contribution plans*

Contributions to defined contribution plans are expensed when incurred.

## v) Taxation

Current and deferred tax for the period is recognised as an expense or income in the income statement. There are two exceptions to this. Firstly, when items are credited or debited directly to equity, the deferred tax or current tax is also recognised directly in equity. Secondly, where tax arises from the initial accounting for a business combination, it is taken into account in the determination of goodwill or excess.

*Current tax*

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

*Deferred tax*

Deferred tax is accounted for using the comprehensive balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax carrying amounts.

In principle, deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets and liabilities are not recognised if the temporary differences arise from the initial recognition of assets and liabilities (other than as a result of a business combination), which affects neither taxable income nor accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, branches, associates and joint ventures except where the consolidated entity is able to control the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets arising from deductible temporary differences associated with these investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to use the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

w) Foreign Currency Transactions

Transactions denominated in a foreign currency that are not hedged are converted at the New Zealand exchange rate at the date of the transaction. Foreign currency receivables and payables at balance date are translated at exchange rates current at balance date. Exchange differences arising on the translation or settlement of accounts payable and receivable in foreign currencies are recognised in the income statement.

Certain purchase commitments denominated in a foreign currency are hedged against foreign currency risk and designated as hedge items in fair value hedges under NZ IAS 39. The cumulative change in the fair value of the purchase commitments attributable to the hedged foreign currency risk is recorded as an asset or liability using forward rate based measurement with the corresponding gains or losses recognised in the income statement. The gains or losses in the associated derivative are also recognised in the income statement.

x) Translation of Foreign Group Entities

The financial statements of each of the Group's subsidiaries are prepared in the functional currency of that entity, being New Zealand dollars, with the exception of d-Cypha Trade Limited. d-Cypha Trade Limited has a functional currency of Australian dollars with its presentational currency being New Zealand dollars. Functional currency is determined for each entity based on the primary economic environment in which it operates. Revenue and expenses are translated at exchange rates at the dates of the transactions. Monetary assets and liabilities are translated at exchange rates current at balance date. Non monetary assets and liabilities are translated at their respective historical exchange rates. The exchange gain or loss arising on translation is recorded in the income statement.

y) Derivative Financial Instruments

Transpower uses derivative financial instruments to reduce its exposures to fluctuations in foreign currency exchanges rates and interest rates. Transpower has designated certain derivatives as hedges, which are used to reduce foreign currency exposure on purchases. These hedges are designated as fair value hedges. For fair value hedging relationships, gains or losses on hedging instruments are included in the income statement together with any change in the fair value of the hedged asset or liability.

For an instrument to qualify as a designated and effective hedging instrument, at the inception of the derivative transaction, the relationship between hedging instruments and hedged items must be documented, as must the Group's risk management objective and strategy for undertaking the hedge. Documentation is maintained upon the effectiveness of the hedge, i.e. whether the hedges are highly effective in offsetting changes in fair values of hedged items.

z) Cash Flow Statement

For the purposes of the cash flow statement, cash is considered to be cash in banks (net of bank overdrafts) plus highly liquid investments that are readily convertible to known amounts of cash, which are subject to an insignificant risk of changes in value. Cash flows from certain items are disclosed net, due to the short term maturities and volume of transactions involved.



[www.transpower.co.nz](http://www.transpower.co.nz)