

Transpower drafting comments and revisions: 26 November 2010



COMMERCE COMMISSION

DECISION NO. [xxx]

Input methodologies determination applicable to **Transpower** pursuant to Part 4 of the Commerce Act 1986 (the Act).

The Commission:

- Dr M Berry
- S Begg
- P Duignan
- PJM Taylor

Summary of the Determination: Pursuant to section 52V(2) of the Act, the **Commerce Commission** hereby publishes input methodologies applicable to electricity lines services supplied by **Transpower**.

Draft as at 24 November 2010

Date of Decision: [xx xxxxx 2010]

This Revised Draft Determination is for consultation purposes only.

Regulation Branch, Commerce Commission

Wellington, NEW ZEALAND

12 November 2010

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REVISED DRAFT COMMERCE ACT (TRANSPOWER INPUT METHODOLOGIES) DETERMINATION 2010

Pursuant to Part 4 of the Commerce Act 1986 the Commerce Commission makes the following determination:

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PART 1 GENERAL PROVISIONS

1.1.1 Title

This determination is the Commerce Act (Transpower Input Methodologies) Determination 2010.

1.1.2 Application

- (1) The **input methodologies** in this determination apply to **electricity transmission services**.
- (2) The **input methodologies** in-

- (a) Part 2 **of this determination** apply in relation to information disclosure regulation under Subpart 4 **of Part 4 of the Act**; and
- (b) Part 3 **of this determination** apply in relation to individual price-quality regulation under Subpart 7 **of Part 4 of the Act**.

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1.1.3 Commencement Date

This determination comes into force on the day after the date on which notice of it is given in the New Zealand Gazette under section 52W of the **Act**.

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1.1.4 Interpretation

- (1) In this determination, unless otherwise stated-
 - (a) references to Parts and Subparts are to named and numbered parts and subparts of the determination;
 - (b) references to 'Subparts' are to Subparts within the same Part in which the reference is made;
 - (c) a word which denotes the singular also denotes the plural and vice versa; and
 - (d) any reference to an amount, value or sum is a reference to an amount, value or sum calculated in relation to **Transpower** in respect of a **disclosure year**.

Comment [A1]: Transpower submits that consistency is needed between the definitions used in the IM determination and in the IPP determination.

- (2) In this determination, including in the schedule, **words or phrases in bold type** bear the following meanings:

X percentile estimate of WACC means **an** estimate, made in accordance with clause 2.4.7(3)(b)(i) and published pursuant to clause 2.4.8, of the **X** percentile for the post-tax **mid-point estimate of WACC**;

2011 thresholds regulatory asset base means the regulatory asset base as defined in the **thresholds notice** as of 30 June 2011;

A

Act means the Commerce Act 1986;

actual controllable opex means, in relation to a disclosure year, the amount of **operating expenditure** made by **Transpower** in the categories to which **allowed controllable opex** relates;

allowed controllable opex means, in a relation to a disclosure year, the allowance specified in an **IPP determination** for **operating expenditure** in categories specified as controllable by **Transpower**;

auditor means a person who **is**-

Comment [A2]: A number of defined terms used in the body of the IM determination have not been put in bold type where they should be. Transpower has marked many such instances, but a thorough check is needed.

Comment [A3]: See Transpower's cover submission.

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Comment [A4]: This term is not defined in the IPP determination – the reference there is to 'opex' – there is a need for consistency in definitions (and defined terms used) between determinations.

Comment [A5]: It is unclear to Transpower where these categories are specified.

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- (a) qualified for appointment as auditor of a company under the Companies Act 1993; ~~and~~
- (b) ~~is independent;~~

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B

business day means any day on which statistics relating to trading in New Zealand government bonds are published by a financial information service such as Bloomberg or Reuters;

C

capital expenditure means costs that-

- (a) have been incurred in the acquisition or development of an asset that is, or is intended to be, **commissioned**; and
- (b) are intended to be included in the **value of commissioned asset**;

Comment [A6]: This definition should be consistent with the definition in the IPP determination.

catastrophic event has the meaning specified in clause 3.7.1;

change event has the meaning specified in clause 3.7.2;

closing RAB value means, for the purpose of-

- (a) Part 2, the value determined in accordance with clause 2.2.3(7); and
- (b) Part 3, the value determined in accordance with clause 2.2.3(7) as modified pursuant to clause 3.3.1;

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Commission means the Commerce Commission;

commissioned means first used by **Transpower** to provide **electricity transmission services**, save that in relation to-

- (a) **land** that is not **easement land**; or
- (b) an **easement**;

whose acquisition was approved under Part F of the Electricity Governance Rules 2003, **the Electricity Industry Participation Code, or an input methodology determined under s 54S of the Act,** 'commissioned' means first acquired by **Transpower**,

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and 'commission' shall be construed accordingly;

Comment [A7]: This definition should be consistent with the definition in the IPP determination.

commissioning date means the date that an asset is **commissioned**;

corporate tax rate means the prevailing rate of income taxation applying to companies as specified in the **tax rules**;

Comment [A8]: Transpower submits that it is unnecessary to define this term as it is now only used once in the determination (and is better defined at that point).

cost of debt is determined in accordance with clause 2.4.1(4);

cost of executing an interest rate swap has the meaning specified in clause 2.4.9(1);

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D

debt premium has the meaning specified in, for the purpose of-

- (a) Part 2, clause 2.4.4(1); and

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(b) Part 3, clause 3.5.4(1);

depreciation, in relation to a **disclosure year**, means the allowance for that **disclosure year** to account for the diminution in an asset's remaining service capability with respect to its **opening RAB value** and such allowance is determined in accordance with clause 2.2.4;

designated transmission customer has the same meaning as defined in the **Electricity Industry Participation Code**;

disclosure year means 12 month period ending on 30 June;

Example: 'disclosure year 2012' means 12 month period ending on 30 June 2012;

disposed asset means an asset that, in the **disclosure year** in question, has been sold or transferred, or has been irrecoverably removed from **Transpower's** possession without **Transpower's** consent, but is not a **lost asset**;

document has the same meaning as defined in s 2 of the **Act**;

E

easement land means **land** acquired with the intention of-

- (a) creating an **easement** in respect of it; and
- (b) disposing of the **land** thereafter;

EDB has the same meaning as defined in the Commerce Commission (Electricity Distribution Input Methodologies) Determination 2010;

Electricity Industry Participation Code means the **Electricity Industry Participation Code 2010 administered by the Electricity Authority, as amended from time to time under sections 38, 40, or 43 of the Electricity Industry Act 2010**;

electricity transmission services means electricity lines services (as 'electricity lines services' is defined in s 54C of the **Act**), **or services directly related to electricity lines services**, supplied by **Transpower**;

error has the meaning specified in clause 3.7.3;

excluded asset means an asset that is-

- (a) not used to **supply electricity transmission services** as on the last day of the **disclosure year 2011**; or
- (b) **easement land**;

F

fixed life easement means an **easement** that-

- (a) is of fixed duration; or
- (b) whilst of indefinite duration, is to be held for a fixed period;

forecast MAR has the same meaning as defined in an **IPP determination**;

found asset has the meaning specified in clause **2.2.7(1)**;

G

Comment [A9]: The meaning of this term is unclear to Transpower. We propose a meeting between Transpower and Commission staff with a view to establishing what is meant and how this can best be reflected in the IM determination.

Comment [A10]: Transpower submits that this term should replace the use of the term 'consumer' in all bar one circumstance as it more clearly captures the intended group of customers.

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Comment [A11]: Transpower suggests inserting this (revised) definition here for improved clarity

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Comment [A12]: Transpower has amended this definition to ensure that all assets that would be considered to be within Transpower's RAB (as an integral part of conveying electricity by line even though they do not directly convey electricity by line - such as monitoring systems), are included.

Comment [A13]: This terms is no longer used in the IM determination - see Transpower's proposed changes to clause 2.2.6.

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<#>a member of the Institution of Professional Engineers New Zealand;¶
<#>acting in that professional capacity; and¶
<#>independent;¶

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GAAP means generally accepted accounting practice, as defined in section 3 of the Financial Reporting Act 1993;

GPB means GDB or GTB, as-

- (a) 'GDB' is defined in the Commerce Commission (Gas Distribution Input Methodologies) Determination 2010; and
- (b) 'GTB' is defined in the Commerce Commission (Gas Transmission Input Methodologies) Determination 2010;

I

ID determination means any information disclosure determination in relation to **Transpower** made by the **Commission** under s 52P of the **Act**, or information disclosure requirements under Subpart 3 of Part 4A of the **Act**, as continued in force by s 54W of the **Act**;

incremental adjustment term means the amount determined in accordance with clause [3.6.2\(6\)](#);

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independent means not in a relationship with, or having an interest in, **Transpower** that is likely to involve him her or it in a conflict of interest between his, her or its duties to **Transpower** and his, her or its duties to the **Commission**;

initial RAB has the meaning specified in clause 2.2.1;

initial RAB value means, in respect of an asset in the **initial RAB**, its value determined in accordance with clause [Q](#);

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input methodology has the same meaning as defined in s 52C of the **Act**;

investment grade credit rated means endorsed with a credit rating by an established credit rating agency (such as Standard and Poor's) of "investment grade" on that agency's credit rating scale applicable to long-term investments;

IPP means individual price-quality path;

IPP determination means any individual price-quality determination applying to **Transpower** made by the **Commission** under s 52P of the **Act**;

L

land excludes-

- (a) buildings; and
- (b) **easements**;

leverage means the ratio of debt capital to total capital and, for the purpose of-

- (a) Part 2, is the amount specified in clause [2.4.2\(1\)](#); and
- (b) Part 3, is the amount specified in clause 3.5.2(1);

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local authority has the same meaning as defined in s 5(1) of the Local Government Act 2002;

lost asset means an asset **commissioned** after the **disclosure year** 2011 having, in relation to a particular **disclosure year**, an **unallocated opening RAB value** but determined by **Transpower** in that **disclosure year** never to have been used to provide **electricity transmission services**;

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M

mid-point estimate of WACC means, for the purpose of-

- (a) Part 2, the mid-point estimate of-
 - (i) vanilla **WACC**; or
 - (ii) post-tax **WACC**,

as the case may be, as each is estimated in accordance with clause 2.4.1; and

- (b) Part 3, the mid-point estimate of vanilla **WACC**, as estimated in accordance with clause 3.5.1;

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N

network spare means an asset that is held by **Transpower** to replace any other asset it holds should that other asset be withdrawn from use owing to failure or damage;

new investment contract means a contract for the provision of new **electricity transmission services** between **Transpower** and another person in respect of which-

- (a) the other person has agreed in writing (whether in the same contract or not) that the terms and conditions of the contact-
 - (i) are reasonable; or
 - (ii) reflect workable or effective competition for the provision of the **electricity transmission services**; or
- (b) **Transpower** demonstrates beyond a reasonable doubt that the terms and conditions of the contract were determined following a process that provided opportunities for-
 - (i) affected customers to make or approve reasonable price-quality trade-offs; and
 - (ii) the competitive provision of new **electricity transmission services** by parties other than **Transpower**;

NZ IAS 17 means New Zealand Equivalent to International Accounting Standard 17 Leases, or any equivalent standard that replaces that standard under **GAAP**;

NZ IAS 38 means New Zealand Equivalent to International Accounting Standard 38 Intangible Assets (as it relates to the cost model of recognition only), or any equivalent standard that replaces that standard under **GAAP**;

O

opening RAB value means the value determined in accordance with, for the purpose of-

- (a) Part 2, clause 2.2.3(6); and
- (b) Part 3, clause 2.2.3(6), as modified pursuant to clause 3.3.1;

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opening year means in respect of-

- (a) **RCP1**, the second **disclosure year** of **RCP1**; and
- (b) **regulatory periods** after **RCP1**, the first **disclosure year** commencing in the **regulatory period**;

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operating cost means expenditure relating to the supply of **electricity transmission services**, and excludes-

- (a) expenditure incurred that is treated as a cost of an asset by **GAAP**; and
- (b) sums relating to depreciation, tax, revaluations and financing;

operating expenditure means **operating costs** after application of clause 3.2.1;

P

pass-through cost has the meaning specified in clause 3.1.2;

physical asset life has the meaning specified in clause [2.2.5](#);

prescribed investor rate has the same meaning as defined in the Income Tax Act 2007 or any subsequent legislation that supplements or replaces the provisions relating to prescribed investor rate in the Income Tax Act 2007;

qualifying rating means -

- (a) a Standard and Poor's long term credit rating of the specified grade; or
- (b) an equivalent long term credit rating of another internationally recognised rating agency;

Q

qualifying debt has the meaning specified in clause 2.4.9(3);

quality targets means the targets specified in clause 4.2 of the **IPP determination** [made on \[\] December 2010](#);

R

RCP1 means the **regulatory period** commencing on 1 April 2011 and ending on 31 March 2015;

recoverable cost has the meaning specified in clause [3.1.3](#);

regulated goods or services has the same meaning as defined in s 52C of the **Act**;

regulated supplier means a supplier of **regulated goods or services**;

regulatory period means the period to which an **IPP determination** relates;

regulatory tax asset value has the meaning specified in clause 2.3.2(1);

related party means-

- (a) a **person** that, in accordance with **GAAP**, is related to **Transpower**; or
- (b) any part of **Transpower** that does not **supply electricity transmission services**;

remaining asset life means the term remaining of an asset's **physical asset life** at the commencement of the **disclosure year** in question;

S

services has the same meaning as defined in s 2 of the **Act**;

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SOSPA means the System Operator Service Provider Agreement between the Electricity Commission (or any successor) and **Transpower** dated 12 August 2009, as amended from time to time, or any successor to that agreement;

standard error means estimated standard deviation;

standard physical asset life means the life specified in Schedule A;

supply has the same meaning as defined in s 2 of the **Act**, and **supplied** must be construed accordingly;

system operator has the meaning as defined in **SOSPA**;

T

tax rules means the rules applicable to **Transpower** in the Income Tax Act 2007 (as amended from time to time, and any equivalent preceding legislation, or any subsequent legislation that supplements or replaces that Act) for determining income tax payable;

term credit spread differential has the meaning specified in clause 2.4.9(2);

thresholds notice means the Commerce Act (Transpower Thresholds) Notice 2008;

Transpower has the same meaning as defined in s 54B of the **Act**;

U

unallocated closing RAB value means the value determined in accordance with clause (a);

unallocated depreciation means an allowance to account for the diminution in an asset's remaining service capability in the **disclosure year** in question with respect to its **unallocated opening RAB value** and the amount of such allowance is determined in accordance with clause Q;

unallocated initial RAB value means, in respect of an asset in the **initial RAB**, its value determined in accordance with clause 2.2.2(1);

unallocated opening RAB value means the value determined in accordance with clause 1.1.1(1);

Remove references to unallocated asset value and unallocated depreciation. If it is the RAB it excludes any items not related to transmission services.

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V

value of commissioned asset means the value determined in accordance with clause 2.2.6;

value of found asset means the value determined in accordance with clause 2.2.7(2);

valuer means an individual who-

- (a) is registered as a valuer under the Valuers Act 1948;
- (b) holds a current practising certificate issued by-
 - (i) the Property Institute of New Zealand; or
 - (ii) the New Zealand Institute of Valuers;
- (c) has been engaged to act in his or her professional capacity as a valuer; and
- (d) is **independent**;

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vanilla NZ\$ denominated bonds means senior unsecured nominal fixed coupon debt obligations denominated in New Zealand dollars without callable, puttable, conversion, profit participation, credit enhancement or collateral features;

W

WACC means weighted average cost of capital;

works under construction means an asset, or a collection of assets that-

- (a) has been or is being constructed by, or on behalf of, **Transpower**;
- (b) has not been **commissioned**; and
- (c) **Transpower** intends to **commission**.

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PART 2 INPUT METHODOLOGIES FOR INFORMATION DISCLOSURE

SUBPART 1 Cost allocation

2.1.1 Cost allocation process

- (1) For the purpose of any requirement in an **ID determination** to disclose-
- (a) asset values;
 - (b) **capital expenditure**; or
 - (c) **operating costs**,
- each must be allocated to-
- (d) activities related to **Transpower's system operator** role; and
 - (e) other activities undertaken by **Transpower** to **supply electricity transmission services**,
- in accordance with the allocation approach in **SOSPA**.

- (2) In this clause, 'asset value' means in respect of an asset used by **Transpower** in the **supply of electricity transmission services**, in-
- (a) the **disclosure year 2011**, its **initial RAB value**; and
 - (b) all other **disclosure years**, its **closing RAB value**.

SUBPART 2 Asset valuation

2.2.1 Composition of initial RAB

- (a) Initial RAB means assets included in the **2011 thresholds regulatory asset base**.

2.2.2 Initial RAB values for assets

- (1) The **initial RAB value** of an asset is its value determined as of 30 June 2011 in accordance with the **thresholds notice**.

2.2.3 RAB roll forward

- (1) Additions to the RAB are in accordance with GAAP and;
 - (2) are to be valued in accordance with a depreciated historical cost valuation;
 - (3) have been approved by the Electricity Commission / Commerce Commission under the procedures in Part F / []
 - (4) [any further inclusions / exclusions]
 - (5)
- (a) an asset first **commissioned** during that **disclosure year**, its **value of commissioned asset**;
 - (b) a **found asset**, its **value of found asset**;
 - (c) a **disposed asset**, nil; and
 - (d) a **lost asset**, nil.

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Comment [A14]: Transpower submits that the use of the term 'unallocated' in relation to asset valuations and RAB calculations is unnecessary as the Thresholds Notice RAB already relates only to assets used for "specified services" (effectively, 'electricity transmission services') and asset values have already been allocated accordingly. This applies equally to future RAB updates. Consequently, the use of the term 'unallocated' unnecessarily complicates this Subpart and Transpower recommends that it be dispensed with.

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excluded assets; ¶
intangible assets, unless they are-¶
recognised under **NZ IAS 17** or **NZ IAS 38**;
and ¶
<#>not goodwill; and¶
works under construction

Comment [A15]: The changes in this clause are by way of example of the level of clarity Transpower seeks in this Subpart. See previous comment.

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<#>adopting its unallocated initial RAB value; and¶
applying clause 2.1.1 to it

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Deleted: <#>Unallocated opening RAB value in respect of an asset in relation to-¶

<#>the **disclosure year 2012**, is its **unallocated initial RAB value**; and¶
a **disclosure year** thereafter, is its **unallocated closing RAB value** in the preceding **disclosure year**.

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<#>an asset with an **unallocated opening RAB value**, the value determined in accordance with the formula-¶

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- (6) **The opening RAB value** in respect of an asset, is, for-
- (a) the **disclosure year 2012**, its **initial RAB value**; and
 - (b) a **disclosure year** thereafter, its **closing RAB value** in the preceding **disclosure year**.

- (7) **The closing RAB value**, in respect of an asset, is determined by-
- (a) adopting its **unallocated closing RAB value**; and
 - (b) **applying clause 2.1.1** to it.

2.2.4 **Depreciation**

Use the Administrative Settlement wording or similar. "Transpower is to receive a return of capital through a depreciation charge based upon the life of the underlying assets. The calculation of the depreciation charge and any asset write-off is to be consistent with GAAP, and is to include "depreciation" relating to the remaining pseudo asset.

2.2.5 **Physical asset life**

- (1) Physical asset life means in the case of-
- (a) a **fixed life easement**, the fixed duration or fixed period (as the case may be) referred to in the definition of **fixed life easement**;
 - (b) a dedicated asset which is not expected to be used by **Transpower** to provide **electricity transmission services** beyond the term of the fixed term agreement relating to the asset between **Transpower** and the **designated transmission customer**, the term of that agreement;
 - (c) an extended life asset or a refurbished asset, its physical service life potential as determined by **Transpower**;
 - (d) an asset that is **stranded**, the physical service life potential specified by the **Commission**;
 - (e) a reduced life asset, its physical service life potential determined by **an independent expert**, subject to subclause (2);
 - (f) a **found asset** for which a similar asset exists as described in subclause 2.2.7(2)(b)(i), the asset life applying to the similar asset;
 - (g) an asset not referred to in paragraphs (a)- (f)-
 - (i) having a **standard physical asset life**, that **standard physical asset life**;
 - (ii) not having a **standard physical asset life**, the **physical asset life** applying to an asset with an **opening RAB value** that is similar in terms of asset type; and
 - (iii) in all other cases, the physical service life potential determined by an **independent expert**;
 - (h) a composite asset, the average asset life of the assets comprising it determined in accordance with paragraphs (a)-(g), with the modification that each such asset life must be weighted with respect to the proportion of its respective **opening RAB value** to the sum of the **opening RAB values** of the components in the earliest **disclosure year** in which all component assets were held by **Transpower**.
- (2) For the purpose of subclause (1)(~~1~~)(e), subject to subclause (3), the determination of asset life by an **independent expert** must be evidenced by a report written by the **independent**

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 $[1 \div \text{remaining asset life}] \times \text{unallocated opening RAB value.¶}$
 <#>Depreciation, in the case of an asset with an **opening RAB value** for a **disclosure year**, is, subject to subclause (3), determined in accordance with the formula-¶
 $[1 \div \text{remaining asset life}] \times \text{opening RAB value.¶}$

Comment [A16]: The meaning of these clauses is unclear to Transpower. We propose a meeting between Transpower and Commission staff with a view to establishing what is meant and how this can best be reflected in the IM determination.

Deleted: <#>For the purposes of subclauses (1) and (2), unallocated depreciation and depreciation are nil in the case of-¶
 <#>&land; ¶
 <#>an **easement** other than a **fixed life easement**; and¶
 <#>a **network spare** in respect of the period before which **Transpower** determines that depreciation for the **network spare** in question commences under **GAAP.¶**
 <#>Unallocated depreciation constraint¶
 For the purpose of clause 2.2.4, the sum of **unallocated depreciation** of an ass(...

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Comment [A17]: Transpower recommends changing the references from 'engineer' to 'independent expert as in ...

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- expert** in question that includes an acknowledgement by the **independent expert** that the report may be publicly disclosed by **Transpower** pursuant to an **ID determination**.
- (3) For the purpose of subclause (2), a determination made in accordance with this clause by an **independent expert** of physical service life potential in relation to an asset with an **unallocated opening RAB value** is deemed applicable to all assets of similar asset type for which there is a requirement in this clause for an **independent expert's** determination of physical service life potential.
- (4) In this clause-
- (a) 'dedicated asset' means an asset operated for the benefit of a particular **designated transmission customer** pursuant to a fixed term agreement for the supply of **electricity transmission services** between **Transpower** and that **designated transmission customer**;
 - (b) 'extended life asset' means an asset whose physical service life potential is greater than its **standard physical asset life**;
 - (c) 'refurbished asset' means an asset on which work (other than maintenance) has been carried out resulting in an extension to its physical service life potential;
 - (d) 'reduced life asset' means an asset determined by **Transpower** to have a physical service life potential shorter than its **standard physical asset life**;
 - (e) 'stranded' means specified by the **Commission** in an **IPP determination** to have-
 - (i) from a specified date, a specified remaining physical service life potential shorter than its **remaining asset life** as of that date; and
 - (ii) a specified physical service life potential in accordance with that remaining physical service life potential; and
 - (f) 'composite asset' means a configuration of two or more assets that is not capable of operation in the absence of any of those assets.

2.2.6 Value of commissioned assets

- (a) an **easement**, is limited to its market value (as defined below) as on its **commissioning date** as determined by a **valuer**, where market value should reflect the reasonable costs of establishing the easement rights, and as such -
- (i) where **Transpower does not own the land over which the easement is being established**, the costs include legal costs plus injurious affection and other payments to the land owner to recognise any permanent and material reduction in the value of the **land** attributable to the creation of the **easement**; and
 - (ii) where **Transpower owns the land over which the easement is being established**, the costs include legal costs and the amount of the reduction in the value of the **land** caused by the creation of the **easement**, and holding costs up to the point that the **land** is sold or the associated asset is commissioned;
- (b) **easement land**, is [1];
- (c) an asset used in providing **electricity transmission services** pursuant to a **new investment contract**, is nil;
- (d) a **network spare-**

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 <#>an intangible asset, unless it is-
 <#>recognised in accordance with **NZ IAS 17** or **NZ IAS 38**; and
 <#>not goodwill,
 is nil;

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Comment [A18]: These paragraphs have been added to reflect the Commission's Updated Decisions.

Comment [A19]: See Transpower's cover submission.

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- (i) which is not required, in light of the historical reliability and number of the assets it is held to replace; **and/or**
- (ii) whose cost is not treated wholly as or part of the cost of an asset under **GAAP**,

is nil;

- (e) an asset-
 - (i) acquired from another **regulated supplier**; and
 - (ii) **which was** used by that **regulated supplier** in the supply of **regulated goods or services**,

is limited to the unallocated opening RAB value of the asset for that other **regulated supplier** as on the **day** before the **commissioning date** (as 'unallocated opening RAB value' is defined in the **input methodologies** applying to the **regulated goods or services supplied** by the other **regulated supplier**);

- (f) an asset that was previously used by **Transpower** in its supply of other **regulated goods or services** is limited to the unallocated opening RAB value of the asset in relation to those other **regulated goods or services** as on the day before the commissioning date (as 'unallocated opening RAB value' is defined in the input methodology determination made under Part 4 of the Act applying to the regulated goods or services supplied by **Transpower**); and
- (g) an asset acquired from a **related party** other than an asset to which paragraphs (e) and (f) apply is-
 - (i) its depreciated historic cost in respect of the **related party** determined by applying **GAAP** as on the day before the acquisition by the **Transpower**; or
 - (ii) where sufficient records do not exist to establish this cost, its market value as at its **commissioning date** as determined by a **valuer**.

(2) When applying **GAAP** for the purpose of subclause 1.1.1(1)(a), the cost of financing is calculated using, subject to (3), a rate no greater than the **X percentile estimate of WACC** applying in respect of the relevant date for its calculation under **GAAP**. **[any difference between WACC and the cost of financing to be washed up through the EV statements]**

(3) Where an asset has not been **commissioned** within the period to which the **X percentile estimate of WACC** referred to in subclause (2) applied, the cost of financing after that period is calculated using a rate no greater than the **X percentile estimate of WACC** applying to that later period.

(4) For the purposes of subclauses (2) and (3), where no **WACC** in respect of the relevant date has been published pursuant to clause 3.5.8, the rate is calculated using a rate no greater than **Transpower's** estimate of its post-tax **WACC** as at the relevant date for its calculation under **GAAP** **[see above]**.

(5) For the avoidance of doubt-

- (a) revenue derived from **works under construction** reduces the cost of **the underlying** asset by the amount of the revenue where such reduction is not otherwise made under **GAAP**;
- (b) where expenditure on an asset is incurred by **Transpower** after that asset was **commissioned**, such expenditure is treated as relating to a **separate asset**; and

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Comment [A20]: Transpower considers that creating the fiction of a separate asset in these circumstances is confusing. We propose a meeting between Transpower and Commission staff with a view to establishing what is meant and how this can best be reflected in the IM determination.

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- (c) when applying **GAAP** for the purpose of subclause 1.1.1(1)(a), the cost of financing ceases to be calculated from the date an asset is **commissioned**.

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2.2.7 Value of found assets

- (1) Found asset means, in relation to a **disclosure year**, an asset-

- (a) the value of which-
 - (i) is not included as an **opening RAB value** in that **disclosure year** in accordance with clause 1.1.1(1); and
 - (ii) was not included in an **closing RAB value** in any prior **disclosure year** in accordance with clause PART 1(a); and
- (b) which was first determined by **Transpower** in that **disclosure year** to have been **commissioned** after the **disclosure year** 2011.

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- (2) The value of found asset for a **found asset** is-

- (a) its depreciated historic cost calculated in accordance with **GAAP**; or
- (b) where sufficient records do not exist to establish its depreciated historic cost for the purposes of **GAAP**,
 - (i) where an asset with an **opening RAB value** for that **disclosure year** is similar (in terms of asset type and age) to the found asset, the **opening RAB value** of the similar asset; and
 - (ii) in all other cases, its market value as determined by a **valuer** as at the date that the asset was first determined by **Transpower** to have been **commissioned** after the **disclosure year** 2011.

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SUBPART 3 Treatment of taxation

Comment [A21]: The meaning of several aspects of this Subpart is unclear to Transpower. We propose a meeting between Transpower and Commission staff with a view to clarifying what the Commission wants to achieve and how this can best be reflected in the IM determination.

2.3.1 Regulatory tax allowance

- (1) The regulatory tax allowance in relation to **Transpower** is determined by applying the **tax rules** and the **corporate tax rate** to the regulatory profit / (loss) before tax.
- (2) For the purpose of subclause (1), 'regulatory profit / (loss) before tax' means the amount of 'regulatory profit / (loss) before tax', 'earnings before tax' or equivalent regulatory profit amounts disclosed pursuant to an **ID determination**.
- (3) For the purpose of subclause (1), in applying the tax rules in respect of particular items of income and expenses included in 'regulatory profit / (loss) before tax'-
 - (a) a tax deduction for interest incurred in relation to debt must be substituted with a tax deduction for notional deductible interest;
 - (b) any tax deduction for depreciation in respect of an asset must be calculated by applying the **tax rules** to the **regulatory tax asset value**; and
 - (c) the effect of any-
 - (i) tax losses (other than those produced from the supply of **electricity transmission services**); and
 - (ii) subvention payment,

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made by **Transpower** must be ignored.

For the avoidance of doubt regulatory tax should comprise Transpower's current tax expense recognised in the period (including any PPA) that relate to the transmission business.

- (4) For the purpose of subclause (3)(a), 'notional deductible interest' means the product of multiplying the sum of the **opening RAB values** by **leverage** and the **cost of debt**.

2.3.2 Regulatory tax asset value

- (1) Regulatory tax asset value means the value determined in accordance with the formula-
tax asset value × asset allocation ratio.

- (2) For the purpose of subclause (1), 'tax asset value' means, subject to subclause (4), the adjusted tax value of an asset.

- (3) In this clause-

- (a) 'adjusted tax value' has the same meaning as in the tax depreciation rules; and
(b) 'tax depreciation rules' means the **tax rules** that relate to the determination of depreciation allowances for tax purposes.

- (4) For the purpose of subclause (2), in respect of an asset-

- (a) acquired from a **regulated supplier** who used it to **supply regulated goods or services**; or
(b) acquired or transferred from a **related party**,

'tax asset value' means the value of the asset determined by applying the tax depreciation rules to the notional tax asset value.

- (5) 'Notional tax asset value' means, for the purpose of-

- (a) subclause (4)(a), value after applying the tax depreciation rules to the tax asset value (as 'tax asset value' is defined in the **input methodologies** applying to the **regulated goods or services** in question) in respect of the **disclosure year** in which the asset was acquired; and
(b) subclause (4)(b), value in respect of the **disclosure year** in which the asset was acquired or transferred that-
(i) is consistent with the **tax rules**; and
(ii) does not exceed the asset's market value as determined by a **valuer**.

- (6) For the purpose of subclause (1), 'asset allocation ratio' means, in respect of an asset maintained under the **tax rules** that-

- (a) has a matching asset maintained for the purpose of Subpart 2, the value obtained in accordance with the formula-

opening RAB value of the matching asset ÷ **unallocated opening RAB value** of the matching asset;

and

- (b) does not have a matching asset for the purpose of Subpart 2, the value obtained in accordance with the formula-

Comment [A22]: Review needed

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$\frac{\text{sum of opening RAB values}_{l \text{ or } g}}{\text{values}_{l \text{ or } g}} \div \text{sum of unallocated opening RAB values}_{l \text{ or } g}$

Comment [A23]: Review needed.

where 'l or g' means-

- (i) in respect of each asset in the group of assets to which the asset in question belongs maintained under the **tax rules** that has a matching group of assets maintained for the purpose of Subpart 2; or
- (ii) in respect of each asset in the group of assets maintained for the purpose of Subpart 2 that has a matching group of assets to which the asset in question belongs maintained under the **tax rules**,

as the case may be. [all this could / should go]

SUBPART 4 Cost of capital

Comment [A24]: Transpower continues to fundamentally disagree with the Commission about various aspects of the cost of capital input methodology and the overall WACC estimate. We refer the Commission to Transpower's cover submission in this regard.

In any event, the meaning of several aspects of this Subpart is unclear to Transpower and / or aspects of the proposed process are impractical to implement. We propose a meeting between Transpower and Commission staff with a view to clarifying what the Commission wants to achieve and how this can best be reflected in the IM determination.

2.4.1 Methodology for estimating weighted average cost of capital

- (1) The **Commission** will calculate a mid-point estimate of vanilla **WACC** for the **disclosure year 2011** and each **disclosure year** thereafter-
 - (a) in respect of the 5 years commencing on the first day of the **disclosure year** in question;
 - (b) subject to subclause (3), within 1 month of the start of the **disclosure year** in question; and
 - (c) in accordance with the formula-

$$r_d L + r_e(1 - L).$$
- (2) The **Commission** will calculate a mid-point estimate of post-tax **WACC** for the **disclosure year 2011** and each **disclosure year** thereafter-
 - (a) in respect of the 5 years commencing on the first day of the **disclosure year** in question;
 - (b) subject to subclause (3), within 1 month of the start of the **disclosure year** in question; and
 - (c) in accordance with the formula-

$$r_d(1 - T_c)L + r_e(1 - L).$$
- (3) The **Commission** will calculate, estimate or determine, as the case may be, the amounts or values-
 - (a) to which this subclause applies; and
 - (b) in respect of the **disclosure year 2011**,
 as soon as practicable after this determination comes into force.
- (4) In this clause-
 - L is **leverage**;
 - r_d is the cost of debt and is estimated by $r_f + p + d$;
 - r_e is the cost of equity and is estimated by $r_f(1 - T_c) + \beta_e \text{TAMRP}$;
 - T_c is the tax rate applicable to companies;
 - r_f is the risk free rate;

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p is the amount of the **debt premium**;
 d is the debt issuance costs;
 T_i is the investor tax rate;
 β_e is the equity beta; and
 $TAMRP$ is the tax-adjusted market risk premium.

- (5) For the purpose of this clause-
- (a) the investor tax rate, the equity beta, the debt issuance costs, the corporate tax rate and the tax-adjusted market risk premium are the values specified in or determined in accordance with clause 2.4.2;
 - (b) the risk free rate must be estimated in accordance with clause 2.4.3; and
 - (c) the amount of the debt premium must be estimated in accordance with clause 2.4.4.

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2.4.2 Fixed WACC parameters

- (1) Leverage is 40%.
- (2) The investor tax rate is-
 - (a) for the **disclosure year** 2011, 28.5%; and
 - (b) for each **disclosure year** thereafter, the maximum **prescribed investor rate** applying at the start of that **disclosure year**.
- (3) The tax rate applicable to companies is-
 - (a) for the **disclosure year** 2011, 30%; and
 - (b) for each **disclosure year** thereafter, the **corporate tax rate**.
- (4) The equity beta is 0.57.
- (5) The debt issuance costs are 0.35%.
- (6) The tax-adjusted market risk premium is, for-
 - (a) the **disclosure year** 2011, 7.1%; and
 - (b) each **disclosure year** thereafter, 7.0%.

2.4.3 Methodology for estimating risk-free rate

The **Commission** will estimate a risk-free rate-

- (a) for each **disclosure year**; and
- (b) subject to clause 2.4.1(3), within 1 month of the start of the **disclosure year** in question,

by-

- (c) obtaining, for New Zealand government New Zealand dollar denominated nominal bonds the wholesale market interpolated **[bid?]** yield to maturity, for a residual period to maturity equal to 5 years on each **business day** in the month immediately preceding the commencement of the **disclosure year**;
- (d) calculating the annualised interpolated bid yield to maturity for each **business day**; and
- (e) calculating the un-weighted arithmetic average of the daily annualised interpolated bid yields to maturity.

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2.4.4 Methodology for estimating debt premium

- (1) Debt premium means the spread between-
- (a) the bid yield to maturity on **vanilla NZ\$ denominated bonds** that-
 - (i) are issued by an **EDB** or a **GPB**;
 - (ii) are publicly traded;
 - (iii) have a **qualifying rating** of grade BBB+; and
 - (iv) have a remaining term to maturity of 5 years; and
 - (b) the contemporaneous interpolated bid yield to maturity of benchmark New Zealand government New Zealand dollar denominated nominal bonds having a remaining term to maturity of 5 years.
- (2) The **Commission** will estimate an amount for the **debt premium**, subject to clause 2.4.1(3), within 1 month of the start of the **disclosure year** in question.
- (3) The amount of the **debt premium** will be estimated for each **disclosure year** by-
- (a) identifying publicly traded **vanilla NZ\$ denominated bonds** that are **investment grade credit rated**;
 - (b) obtaining, in respect of each bond identified in accordance with paragraph (a)-
 - (i) its wholesale market bid yield to maturity; and
 - (ii) its contemporaneous interpolated bid to bid spread over benchmark New Zealand government New Zealand dollar denominated nominal bonds,for each business day in the month immediately preceding the start of the **disclosure year**;
 - (c) calculating, for each such bond, the un-weighted average of the spreads identified in accordance with paragraph (b)(ii); and
 - (d) subject to subclause (4), estimating, by taking account of the average spreads identified in accordance with paragraph (c), the average spread that would reasonably be expected to apply to **vanilla NZ\$ denominated bonds** that-
 - (i) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (ii) are publicly traded;
 - (iii) have a **qualifying rating** of grade BBB+; and
 - (iv) have a remaining term to maturity of 5 years.
- (4) For the purpose of subclause (3)(d), the **Commission** will have regard, subject to subclauses (5) and (6), to the spreads observed on the following types of **vanilla NZ\$ denominated bonds**:
- (a) those that-
 - (i) have a **qualifying rating** of grade BBB+; and
 - (ii) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (b) those that-
 - (i) have a **qualifying rating** of grade BBB+; and
 - (ii) are issued by an entity other than an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;

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- (c) those that-
 - (i) have a **qualifying rating** of a grade different to BBB+; and
 - (ii) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
- (d) those that-
 - (i) have a **qualifying rating** of a grade different to BBB+; and
 - (ii) are issued by an entity, other than an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**; and
- (e) those that are-
 - (i) **investment grade credit rated**; and
 - (ii) issued by an entity that is majority owned by the Crown or a **local authority**.

- (5) For the purpose of subclause (4), progressively lesser regard must be given to the spreads observed on the bonds types described in subclause (4) in accordance with the order in which the bond types are described.
- (6) In having regard to spreads observed on bonds described under subclauses (4)(b) to (4)(e), the **Commission** will adjust such spreads to approximate the spread that is likely to have been observed had the bonds in question been of the type described in subclause (4)(a).

2.4.5 Standard error of debt premium

The **Commission** will estimate an amount for a **standard error** of the debt premium-

- (a) subject to clause 2.4.1(3), within 1 month of the start of the **disclosure year** in question; and
- (b) in accordance with the formula-

$$\sqrt{\frac{1}{N-1} \sum_{i=1}^N (p_i - \bar{p})^2}$$

where,

N is the number of bonds of the type described in the subparagraphs of clause 2.4.4(3)(d);

p_i is the spread on each bond of the type described in the subparagraphs of clause 2.4.4(3)(d); and

\bar{p} is the amount of the **debt premium** obtained in accordance with clause 2.4.4(3),

provided that for the purposes of determining N and p_i , no regard may be had to any bonds of the types described in clause 2.4.4(4)(b) to clause 2.4.4(4)(e).

2.4.6 Methodology for estimating the WACC standard error

- (1) The **Commission** will determine an amount for a **standard error** of a **mid-point estimate of WACC**-
 - (a) subject to clause 2.4.1(3), within 1 month of the start of the **disclosure year** in question; and
 - (b) in accordance with this clause.

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- (2) The **standard error** for a mid-point estimate of vanilla **WACC** determined in accordance with clause 2.4.1(1) will be determined in accordance with the formula-

$$\sqrt{0.00003 + 0.0169 E^2 (TAMRP) + 0.16 \text{var}(\hat{p})}$$

- (3) The **standard error** for a mid-point estimate of post-tax **WACC** determined in accordance with clause ~~2.4.1(2)~~ will be determined in accordance with the formula-

$$\sqrt{0.00003 + 0.0169 E^2 (TAMRP) + (-T_c)(0.16 \text{var}(\hat{p}))}$$

- (4) In this clause-

$E^2 (TAMRP)$ is the square of the tax-adjusted market risk premium determined in accordance with clause 2.4.2(6);

$\text{var}(\hat{p})$ is the square of the **standard error** of the debt premium determined in accordance with clause 2.4.5; and

T_c is the corporate tax rate determined in accordance with clause 2.4.2(3).

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2.4.7 Methodology for estimating the WACC range

- (1) WACC ranges for **mid-point estimates of WACC** will be determined by the **Commission-**
- (a) for each **disclosure year**; and
 - (b) subject to clause 2.4.1(3), within 1 month of the start of the **disclosure year** in question.

Comment [A25]: Transpower notes that the figures in this clause will require adjustment once the 'X percentile estimate of WACC' is settled – see Transpower's cover submission and related papers.

- (2) For the purpose of subclause (1), 'WACC range' means the values falling between the ~~X~~ percentile and ~~X~~ percentile inclusive of a **mid-point estimate of WACC**.

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- (3) For the purpose of subclause (2)-

- (a) the **mid-point estimate of WACC** must be treated as the ~~X~~ percentile; and
- (b) the

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- (i) ~~X~~ percentile must be determined in accordance with the formula-

mid-point estimate of WACC + 0.674 × *standard error*; and

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- (ii) ~~X~~ percentile must be determined using the formula-

mid-point estimate of WACC - 0.674 × *standard error*,

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where 'standard error' means the **standard error** of the relevant **mid-point estimate of WACC**.

2.4.8 Publication of estimates relating to cost of capital

The Commission will publish all estimates that it is required to make by this Subpart-

- (a) on its website; and
- (b) no later than one month after having made them.

Comment [A26]: Transpower notes that there are a number of practical difficulties with the term credit spread differential as drafted by the Commission – we refer the Commission to Transpower's cover submission.

2.4.9 Interpretation of terms relating to term credit spread differential

- (1) Cost of executing an interest rate swap means, where an interest rate swap has been executed in respect of a **qualifying debt**, the amount determined in accordance with the formula-

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$A \times B$,

where-

- (a) 'A' is the amount that is half of the wholesale bid and offer spread for the interest rate swap determined at the time of executing the swap, (which, for the avoidance of doubt, is expressed in terms of basis points per annum), provided that-
 - (i) execution of the interest rate swap occurred within 1 week of the pricing or issuing of the **qualifying debt**; and
 - (ii) the actual cost has been certified as accurate by the **auditor of Transpower's** financial statements; and
- (b) 'B' is the lesser of the-
 - (i) notional principal amount of the interest rate swap; and
 - (ii) book value in New Zealand dollars of the **qualifying debt** at its date of issue.

(2) Term credit spread differential means, in relation to a **qualifying debt**, the sum of the-

- (a) term credit spread difference; and
- (b) cost of executing an interest rate swap, offset by a reallocation of notional debt issuance cost.

(3) Qualifying debt means a line of debt-

- (a) with an original tenor greater than 5 years; and
- (b) issued by **Transpower**.

2.4.10 **Methodology for estimating term credit spread differential**

(1) This clause applies to the determination of the amount of any **term credit spread differential** in respect of a **qualifying debt** for the purpose of disclosure pursuant to an **ID determination** of a-

- (a) **term credit spread differential allowance**; or
- (b) **term credit spread differential**.

(2) Disclosure to which this clause applies may only be made by **Transpower** if its debt portfolio, as at the date of its most recently published audited financial statements, has a weighted average original tenor greater than 5 years.

(3) The amount of a **term credit spread differential** must be determined in accordance with the formula-

$(A \div B) \times C \times D$,

where-

- (a) 'A' is the sum of the-
 - (i) term credit spread difference, as determined in accordance with clause 2.4.11;
 - (ii) **cost of executing an interest rate swap**; and
 - (iii) debt issuance cost re-adjustment, as determined in accordance with subclause (4);
- (b) 'B' is the book value of **Transpower's** total interest-bearing debt as at the date to which its most recently published audited financial statements relate;

Comment [A27]: Transpower notes that there are a number of practical difficulties with the term credit spread differential as drafted by the Commission – we refer the Commission to Transpower's cover submission.

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- (c) 'C' is **leverage**; and
- (d) 'D' is, in relation to **Transpower**, the average of-
 - (i) the sum of **opening RAB values**; and
 - (ii) the sum of **closing RAB values**.

- (4) For the purpose of subclause (3)(a)(iii) the amount of the debt issuance cost re-adjustment is determined in accordance with the formula-

$$((0.0175 \div \textit{original tenor of the qualifying debt}) - 0.0035) \times \textit{book value in New Zealand dollars of the qualifying debt at its date of issue},$$

which amount, for the avoidance of doubt, will be a negative number.

2.4.11 **Term credit spread difference**

- (1) For the purpose of clause 2.4.10(3)(a)(i), the term credit spread difference is determined in accordance with the formula-

$$((V - W) - (X - Y)) \times Z,$$

where-

- (a) 'V', subject to subclause (2), is the interpolated wholesale market bid yield to maturity of **vanilla NZ\$ denominated bonds** that-
 - (i) are publicly traded;
 - (ii) have a remaining term to maturity equal to the original tenor of each **qualifying debt**; and
 - (iii) have a Standard & Poor's long-term credit rating of 'BBB+' or an equivalent rating from another internationally recognised rating agency;
- (b) 'W' is the swap rate with a tenor equal to the original tenor of the **qualifying debt**;
- (c) 'X', subject to subclause (2), is the interpolated wholesale market bid yield to maturity of **vanilla NZ\$ denominated bonds** that-
 - (i) are publicly traded;
 - (ii) have a remaining term to maturity equal to 5 years; and
 - (iii) have a Standard & Poor's long-term credit rating of 'BBB+' or an equivalent rating from another internationally recognised rating agency;
- (d) 'Y' is the swap rate with a tenor of 5 years;
- (e) V, W, X and Y are determined as at the same time on the same pricing date of the **qualifying debt**; and
- (f) 'Z' is the book value in New Zealand dollars of the **qualifying debt** at its date of issue,

- (2) For the purposes of subclauses (1)(a) and (1)(c), V and X must each be determined, subject to subclause (3), by taking account of the average wholesale market bid yields to maturity that would reasonably be expected to apply to **vanilla NZ\$ denominated bonds** that-

- (a) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
- (b) are publicly traded;
- (c) have a **qualifying rating** of grade BBB+; and
- (d) have a remaining term to maturity of-
 - (i) in the case of V, each **qualifying debt**; and

Comment [A28]: Transpower notes that there are a number of practical difficulties with the term credit spread differential as drafted by the Commission – we refer the Commission to Transpower's cover submission.

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- (ii) in the case of X, 5 years.
- (3) For the purpose of subclause (2), regard must be had, subject to subclauses (4) and (5), to the wholesale market bid yields to maturity observed on the following types of **vanilla NZ\$ denominated bonds**:
 - (a) those that-
 - (i) have a **qualifying rating** of grade BBB+; and
 - (ii) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (b) those that-
 - (i) have a **qualifying rating** of grade BBB+; and
 - (ii) are issued by an entity other than an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (c) those that-
 - (i) have a **qualifying rating** of a grade different to BBB+; and
 - (ii) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (d) those that-
 - (i) have a **qualifying rating** of a grade different to BBB+; and
 - (ii) are issued by an entity, other than an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**; and
 - (e) those that are-
 - (i) **investment grade credit rated**; and
 - (ii) issued by an entity that is majority owned by the Crown or a **local authority**.
- (4) For the purpose of subclause (3), progressively lesser regard must be given to the wholesale market bid yields to maturity observed on the bonds types described in subclause (3) in accordance with the order in which the bond types are described.
- (5) In having regard to the wholesale market bid yields to maturity observed on bonds described under subclauses (3)(b) to (3)(e), an adjustment must be made to such wholesale market bid yields to maturity to approximate the wholesale market bid yield to maturity that is likely to have been observed had the bonds in question been of the type described in subclause (3)(a).
- (6) Regard may be had, in the absence of information on wholesale market bid yields to maturity on the type of bonds described in subclause (3) that have a term to maturity of-
 - (a) in the case of V, each **qualifying debt**; and
 - (b) in the case of X, 5 years,to the Australian or United States Bloomberg 'BBB' or 'A' fair value curves, or any similar curves published by Bloomberg in respect of Australia or the United States of America, relative to their respective Bloomberg Australian or United States swap curves, treating either one of the resulting indicative spreads, when added to the Bloomberg New Zealand swap curve, as the wholesale market bid yield to maturity.

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PART 3 INPUT METHODOLOGIES APPLYING TO INDIVIDUAL PRICE-QUALITY PATH

SUBPART 1 Specification of price

3.1.1 Price

For the purpose of s 53M(1)(a) of the Act, the maximum revenues that may be recovered by **Transpower** will be specified in an **IPP** determination as a total revenue cap, net of-

- (a) the sum of **pass-through costs**; and
- (b) the sum of **recoverable costs**.

3.1.2 Pass-through cost requirements

- (1) A pass-through cost is a cost that-
 - (a) is listed in subclause (2); or
 - (b) is a levy otherwise than one to which paragraph (a) applies that meets the criteria specified in subclause (3).
- (2) For the purpose of subclause (1)(a), the costs are-
 - (a) rates on system fixed assets paid or payable by **Transpower** to a **local authority** under the-
 - (i) Ratings Powers Act 1988 (as amended from time to time, or any successor to that Act); or
 - (ii) Local Government (Rating) Act 2002 (as amended from time to time, or any successor to that Act); and
 - (b) levies payable under regulations made under-
 - (i) s 53ZE of the Act (as amended from time to time, or any successor to that Act); or
 - (ii) the Electricity Industry Act 2010 (as amended from time to time, or any successor to that Act).
- (3) For the purpose of subclause (1)(b), the criteria are that the levy-
 - (a) is-
 - (i) associated with the provision of **electricity transmission services**;
 - (ii) outside the control of **Transpower**;
 - (iii) not a **recoverable cost**;
 - (iv) appropriate to be passed through to **consumers** (as defined in s 2(1) of the Electricity Act 1992); and
 - (v) one in respect of which provision for its recovery is not made explicitly or implicitly in the **IPP**;
 - (b) was reasonably unforeseen **by Transpower** at the time the **IPP determination** was made;
 - (c) comes into effect during any **disclosure year** commencing in a **regulatory period**; and

Comment [A29]: Transpower submits that logically, the IMs for the IPP determination should come first and information disclosure would follow – this also better reflects the level of regulatory control being imposed. See earlier drafting submissions (August 2010). Transpower recommends that the Commission switches Parts 2 and 3 around, with necessary drafting changes.

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Comment [A30]: This is no longer a defined term as this is the only instance where the term is used.

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- (d) is specified as a 'pass-through cost' by way of amendment to the **IPP determination**.
- (4) In this clause, 'levy' means a tax, charge or fee directly imposed by or under legislation-
 - (a) on-
 - (i) **Transpower** alone; or
 - (ii) a class of persons (other than the general public or businesses in general) that includes **Transpower**; or
 - (b) in relation to **electricity transmission services**.

3.1.3 Recoverable costs

- (1) A recoverable cost is a cost that is-
 - (a) any positive net balance determined in accordance with clauses 3.6.3(2) or 3.6.3(3), provided that any requirements pursuant to an **IPP determination** regarding auditor certification of the value determined in accordance with those clauses have been met;
 - (b) subject to subclause (2), an instantaneous reserves availability charge, being a charge allocated to **Transpower** under-
 - (i) clause 8.59 of the **Electricity Industry Participation Code**; or
 - (ii) any other provision dealing with instantaneous reserves availability charges in any subsequent legislation,net of any rebate received by **Transpower** in accordance with clause 8.65 of the **Electricity Industry Participation Code**; and
 - (c) a transmission alternative operating cost, subject to the requirements in subclause (4).
- (2) For the purpose of subclause (1)(b) an instantaneous reserves availability charge excludes-
 - (a) any 'event charges' payable by **Transpower**, as defined under clause 8.64 of the **Electricity Industry Participation Code**, or any provision dealing with 'event charges' in any subsequent legislation;
 - (b) 50% of any such charge incurred by **Transpower** in relation to an asset remaining out of service after an initial period of 14 consecutive days out of service, insofar as the cumulative amount so incurred is less than or equal to 1% of **Transpower's forecast MAR** for the **disclosure year** in which the event causing the asset to be out of service commences, as specified in the **IPP determination**;
 - (c) any such charge treated by Transpower as **capital expenditure in accordance with GAAP** in relation to the control systems integration of Pole 2 and the commissioning of Pole 3 of the HVDC link; and
 - (d) any such charge that is treated as having been inefficiently incurred by NZ IAS 16.
- (3) For the avoidance of doubt, any instantaneous reserves availability charge incurred as a result of the decommissioning of Pole 1 and the commissioning and upgrading of Pole 3 and 2 respectively of js not subject to the 14 day rule.
- (4) For the purpose of subclause (1)(c), the requirements are that the cost must-
 - (a) be **operating expenditure**;

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- Comment [A31]: We refer the Commission to Transpower's cover submission in relation to this issue.
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- Comment [A32]: This has been revised to align with the Commission's Updated Decisions
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- (b) be incremental to the **operating expenditure** allowance specified by the **Commission** in the **IPP**;
- (c) have been approved by the-
 - (i) Electricity Commission or the Electricity Authority under Part F of the Electricity Governance Rules 2003 or the Electricity Industry Participation Code; or
 - (ii) **Commission** in accordance with any **input methodology** determined pursuant to s 54S of the **Act**; and
- (d) be the-
 - (i) actual transmission alternative operating cost incurred by **Transpower**; or
 - (ii) upper limit of transmission alternative operating costs approved in accordance with paragraph (c),whichever is the lower.

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(5) In this clause-

- (a) 'Electricity Authority' means the authority established under s 12 of the Electricity Industry Act 2010;
- (b) 'Electricity Commission' means the same body as the Electricity Governance Board established under s 172M of the Electricity Act 1992 as in force immediately before its substitution by s 14 of the Electricity Amendment Act 2004.

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SUBPART 2 Cost allocation

3.2.1 Cost allocation

- (1) For the purpose of making an **IPP determination**, information provided to the **Commission** by **Transpower** regarding **Transpower's operating costs** and **capital expenditure**, whether actual or forecast, must be provided in accordance with clause 2.1.1 with necessary modifications.
- (2) For the avoidance of doubt, in applying subclause (1), any reference to 'any requirement in an ID determination' in Subpart 1 of Part 2 means 'any requirement specified by the **Commission**'.

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SUBPART 3 Asset valuation

3.3.1 Asset valuation

For the purpose of making an **IPP determination**-

- (a) the value of an asset; and
- (b) any allowance for depreciation,

must be determined, in accordance with the **input methodologies** specified in Subpart 2 of Part 2, with necessary modifications, and in particular to allow-

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- (c) such values or allowances to be calculated on a forecast basis where required; and
- (d) for the purposes of determining **forecast MAR** and associated annual wash-ups, the determination of the **value of commissioned asset** by reference to approved amounts of capital expenditure.

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SUBPART 4 Treatment of taxation

3.4.1 Treatment of taxation

- (1) For the purpose of making an **IPP determination**, **Transpower's** regulatory tax allowance whether on an actual or forecast basis, must be determined in accordance with the **input methodologies** specified in Subpart 3 of Part 2 **of this determination** with necessary modifications.
- (2) For the avoidance of doubt, in applying subclause (1), any reference to 'as determined in accordance with an ID determination' in Subpart 3 of Part 2 shall be construed as 'as specified by the **Commission**'.

Comment [A33]: The meaning of several aspects of Subpart 3 of Part 2 of this determination is unclear to Transpower. We propose a meeting between Transpower and Commission staff with a view to clarifying what the Commission wants to achieve and how this can best be reflected in the IM determination.

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SUBPART 5 Cost of capital

3.5.1 Methodology for estimating weighted average cost of capital

- (1) The **Commission** will calculate mid-point estimates of vanilla **WACC** for-
 - (a) each **regulatory period** in respect of the 5 years commencing on the first **business day** of the month 7 months preceding the start of the **regulatory period**;
 - (b) subject to subclause (2), no later than 6 months preceding the start of **RCP1** or each other **regulatory period** as the case may be; and
 - (c) in accordance with the formula-
$$r_d L + r_e(1 - L).$$
- (2) The **Commission** will calculate, estimate or determine, as the case may be, the amounts or values-
 - (a) to which this subclause applies; and
 - (b) in respect of **RCP1**,as soon as practicable after this determination comes into force.

Comment [A34]: Transpower continues to fundamentally disagree with the Commission about various aspects of the cost of capital input methodology and the overall WACC estimate. We refer the Commission to Transpower's cover submission in this regard.

In any event, the meaning of several aspects of this Subpart is unclear to Transpower. We propose a meeting between Transpower and Commission staff with a view to clarifying what the Commission wants to achieve and how this can best be reflected in the IM determination.

- (3) In this clause-
 - L is **leverage**;
 - r_d is the cost of debt and is estimated by $r_f + p + d$;
 - r_e is the cost of equity and is estimated by $r_f(1 - T_i) + \theta_e TAMRP$;
 - r_f is the risk-free rate;
 - p is the amount of the **debt premium**;
 - d is the debt issuance costs;
 - T_i is the investor tax rate;

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β_e is the equity beta; and
 $TAMRP$ is the tax-adjusted market risk premium.

(4) For the purpose of this clause-

- (a) the investor tax rate, the equity beta, the debt issuance costs, and the tax-adjusted market risk premium are the values specified in or determined in accordance with clause 3.5.2;
- (b) the risk-free rate must be estimated for the first **business day** of the month 7 months preceding the start of **RCP1** or any other **regulatory period**, as the case may be, in accordance with clause 3.5.3; and
- (c) the debt premium must be estimated for the first **business day** of the month 7 months preceding the start of **RCP1** or any other **regulatory period**, as the case may be, in accordance with clause 3.5.4.

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3.5.2 Fixed WACC parameters

- (1) Leverage is 40%.
- (2) The investor tax rate is-
 - (a) until 31 March 2011, 28.5%; and
 - (b) on and after 1 April 2011, the maximum **prescribed investor rate**.
- (3) The equity beta is 0.57.
- (4) The debt issuance costs are 0.35%.
- (5) The tax-adjusted market risk premium-
 - (a) until 30 June 2011, is 7.1%; and
 - (b) on and after 1 July 2011, 7%.

3.5.3 Methodology for estimating risk-free rate

The **Commission** will estimate a risk-free rate-

- (a) as of the first **business day** of the month 7 months preceding the start of each **regulatory period**;
- (b) in respect of a 5 year period; and
- (c) subject to clause 3.5.1(2), no later than 6 months preceding the start of the **regulatory period** in question,

by-

- (d) obtaining, for New Zealand government New Zealand dollar denominated nominal bonds the wholesale market interpolated mid yield to maturity, for a residual period to maturity equal to 5 years on each **business day** in the month 8 months preceding the start of each **regulatory period**;
- (e) calculating the annualised interpolated bid yield to maturity for each **business day**; and
- (f) calculating the un-weighted arithmetic average of the daily annualised interpolated bid yields to maturity.

3.5.4 Methodology for estimating debt premium

(1) Debt premium means the spread between-

- (a) the bid yield to maturity on **vanilla NZ\$ denominated bonds** that-

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- (i) are issued by an **EDB** or a **GPB**;
 - (ii) are publicly traded;
 - (iii) have a **qualifying rating** of grade BBB+; and
 - (iv) have a remaining term to maturity of 5 years; and
- (b) the contemporaneous interpolated bid yield to maturity of benchmark New Zealand government New Zealand dollar denominated nominal bonds having a remaining term to maturity of 5 years.
- (2) The **Commission** will estimate an amount for the **debt premium**, subject to clause 3.5.1(2), no later than 6 months preceding the start of each **regulatory period**.
- (3) The amount of the **debt premium** will be estimated as of the first **business day** of the month 7 months preceding the start of each **regulatory period** by-
- (a) identifying publicly traded **vanilla NZ\$ denominated bonds** that are **investment grade credit rated**;
 - (b) obtaining, in respect of each bond identified in accordance with paragraph (a)-
 - (i) its wholesale market bid yield to maturity; and
 - (ii) its contemporaneous interpolated bid to bid spread over benchmark New Zealand government New Zealand dollar denominated nominal bonds,for each **business day** in the month 8 months preceding the start of the **regulatory period**;
 - (c) calculating, for each such bond, the un-weighted average of the spreads identified in accordance with paragraph (b)(ii); and
 - (d) subject to subclause (4), estimating, by taking account of the average spreads identified in accordance with paragraph (c), the average spread that would reasonably be expected to apply to **vanilla NZ\$ denominated bonds** that-
 - (i) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (ii) are publicly traded;
 - (iii) have a **qualifying rating** of grade BBB+; and
 - (iv) have a remaining term to maturity of 5 years.
- (4) For the purpose of subclause 3.5.4(3)(d), the **Commission** will have regard, subject to subclauses (5) and (6), to the spreads observed on the following types of **vanilla NZ\$ denominated bonds**:
- (a) those that-
 - (i) have a **qualifying rating** of grade BBB+; and
 - (ii) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (b) those that-
 - (i) have a **qualifying rating** of grade BBB+; and
 - (ii) are issued by an entity other than an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (c) those that-
 - (i) have a **qualifying rating** of a grade different to BBB+; and

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- (ii) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (d) those that-
 - (i) have a **qualifying rating** of a grade different to BBB+; and
 - (ii) are issued by an entity, other than an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**; and
 - (e) those that are-
 - (i) **investment grade credit rated**; and
 - (ii) issued by an entity that is majority owned by the Crown or a **local authority**.
- (5) For the purpose of subclause (4), progressively lesser regard must be given to the spreads observed on the bonds types described in subclause (4) in accordance with the order in which the bond types are described.
- (6) In having regard to spreads observed on bonds described under subclauses (4)(b) to (4)(e), the **Commission** will adjust such spreads to approximate the spread that is likely to have been observed had the bonds in question been of the type described in subclause (4)(a).

3.5.5 Standard error of debt premium

The **Commission** will estimate an amount for a **standard error** of a debt premium-

- (a) subject to clause 3.5.1(2), no later than 6 months preceding the start of each **regulatory period**; and
- (b) in accordance with the formula-

$$\sqrt{\frac{1}{N-1} \sum_{i=1}^N (p_i - \bar{p})^2}$$

where,

N is the number of bonds of the type described in the subparagraphs of clause 3.5.4(3)(d) ;

p_i is the spread on each bond of the type described in the subparagraphs of clause 3.5.4(3)(d); and

\bar{p} is the amount of the **debt premium** obtained in accordance with clause 3.5.4.

provided that for the purposes of determining N and p_i , no regard may be had to any bonds of the types described in clauses 3.5.4(4)(b) to 3.5.4(4)(e).

3.5.6 Methodology for estimating the WACC standard error

The **Commission** will determine **standard errors** for **mid-point estimates of WACC**-

- (a) subject to clause 3.5.1(2), no later than 6 months preceding the start of each **regulatory period**; and
- (b) in accordance with the formula-

$$\sqrt{0.00003 + 0.0169 E^2 (TAMRP) + 0.16 \text{var}(\hat{p})}$$

where-

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$E^2(TAMRP)$ is the square of the tax-adjusted market risk premium determined in accordance with clause 3.5.2(5); and

$\text{var}(\hat{p})$ is the square of the **standard error** of the **debt premium** determined in accordance with clause 3.5.5.

3.5.7 **Methodology for estimating X percentile of vanilla WACC**

- (1) A **X percentile estimate of WACC** will be estimated by the **Commission** no later than 6 months preceding the start of each **regulatory period**.
- (2) For the purpose of subclause (1)-
 - (a) the **mid-point estimate of WACC** must be treated as the **X percentile**; and
 - (b) the **X percentile** must be determined in accordance with the formula-

$$\text{mid-point estimate of WACC} + 0.674 \times \text{standard error},$$

where 'standard error' means the **standard error** of the **mid-point estimate of WACC**, as determined in accordance with clause 3.5.6.

3.5.8 **Publication of estimates**

The **Commission** will publish all estimates that it is required to make by this Subpart-

- (a) on its website; and
- (b) no later than 1 month after having made them.

3.5.9 **Use of published estimates of WACC**

For the purpose of setting a price path in an **IPP determination**, the **WACC** published in accordance with clause 3.5.8 most recently prior to the start of the **regulatory period** in question must be applied in respect of each **disclosure year** commencing in the **regulatory period**.

3.5.10 **Methodology for estimating term credit spread differential**

- (1) This clause applies to the determination of the amount of any **term credit spread differential** in respect of a **qualifying debt** for the purpose of determining a **term credit spread differential allowance** in an **IPP determination**.
- (2) The **Commission** will only determine a **term credit spread differential allowance** if **Transpower's** debt portfolio, as at the date of its most recently published audited financial statements, has a weighted average original tenor greater than 5 years.
- (3) The amount of a **term credit spread differential** must be determined in accordance with the formula-

$$(A \div B) \times C \times D,$$

where-

- (a) 'A' is the sum of the-
 - (i) term credit spread difference, as determined in accordance with clause 3.5.11;
 - (ii) **cost of executing an interest rate swap**; and
 - (iii) debt issuance cost re-adjustment, as determined in accordance with subclause (4);

Comment [A35]: Transpower notes that the figures in this clause will require adjustment once the 'X percentile estimate of WACC' is settled – see Transpower's cover submission and related papers.

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Comment [A36]: Transpower notes that there are a number of practical difficulties with the term credit spread differential as drafted by the Commission – we refer the Commission to Transpower's cover submission.

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- (b) 'B' is the book value of the qualifying supplier's total interest-bearing debt as at the date to which the supplier's most recently published audited financial statements relate;
- (c) 'C' is **leverage**; and
- (d) 'D' is, in relation to the qualifying supplier, the average of-
 - (i) the sum of **opening RAB values**; and
 - (ii) the sum of **closing RAB values**.

- (4) For the purpose of subclause (3)(a)(iii), the amount of the debt issuance cost re-adjustment is determined in accordance with the formula-

$((0.0175 \div \text{original tenor of the qualifying debt}) - 0.0035) \times \text{book value in New Zealand dollars of the qualifying debt at its date of issue,}$

which amount, for the avoidance of doubt, will be a negative number.

3.5.11 **Term credit spread difference**

- (1) For the purpose of clause 3.5.10(3)(a)(i), the term credit spread difference is determined in accordance with the formula-

$((V - W) - (X - Y)) \times Z,$

where-

- (a) 'V', subject to subclause (2), is the interpolated wholesale market bid yield to maturity of **vanilla NZ\$ denominated bonds** that-
 - (i) are publicly traded;
 - (ii) have a remaining term to maturity equal to the original tenor of each **qualifying debt**; and
 - (iii) have a Standard & Poor's long-term credit rating of 'BBB+' or an equivalent rating from another internationally recognised rating agency;
- (b) 'W' is the swap rate with a tenor equal to the original tenor of the **qualifying debt**;
- (c) 'X', subject to subclause (2), is the interpolated wholesale market bid yield to maturity of **vanilla NZ\$ denominated bonds**, that-
 - (i) are publicly traded;
 - (ii) have a remaining term to maturity equal to 5 years; and
 - (iii) have a Standard & Poor's long-term credit rating of 'BBB+' or an equivalent rating from another internationally recognised rating agency;
- (d) 'Y' is the swap rate with a tenor of 5 years;
- (e) V, W, X and Y are determined as at the same time on the same pricing date of the **qualifying debt**; and
- (f) 'Z' is the book value in New Zealand dollars of the **qualifying debt** at its date of issue,

- (2) For the purposes of subclauses (1)(a) and (1)(c), V and X must each be determined, subject to subclause (3), by taking account of the average wholesale market bid yields to maturity that would reasonably be expected to apply to **vanilla NZ\$ denominated bonds** that-

- (a) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
- (b) are publicly traded;

Comment [A37]: Transpower notes that there are a number of practical difficulties with the term credit spread differential as drafted by the Commission – we refer the Commission to Transpower's cover submission.

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- (c) have a **qualifying rating** of grade BBB+; and
 - (d) have a remaining term to maturity of-
 - (i) in the case of V, each **qualifying debt**; and
 - (ii) in the case of X, 5 years.
- (3) For the purpose of subclause (2), regard must be had, subject to subclause (4), to the wholesale market bid yields to maturity observed on the following types of vanilla NZ\$ denominated bonds:
- (a) those that-
 - (i) have a **qualifying rating** of grade BBB+; and
 - (ii) are issued by an **EDB** or a **GPB** or that is neither majority owned by the Crown nor a **local authority**;
 - (b) those that-
 - (i) have a **qualifying rating** of grade BBB+; and
 - (ii) are issued by an entity other than a an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (c) those that-
 - (i) have a **qualifying rating** of a grade different to BBB+; and
 - (ii) are issued by an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**;
 - (d) those that-
 - (i) have a **qualifying rating** of a grade different to BBB+; and
 - (ii) are issued by an entity, other than an **EDB** or a **GPB** that is neither majority owned by the Crown nor a **local authority**; and
 - (e) those that are-
 - (i) **investment grade credit rated**; and
 - (ii) issued by an entity that is majority owned by the Crown or a **local authority**.
- (4) For the purpose of subclause (2)(d), progressively lesser regard must be given to the wholesale market bid yields to maturity observed on the bond types described in that subclause in accordance with the order in which the bond types are described.
- (5) In having regard to the wholesale market bid yields to maturity observed on bonds described under subclauses (3)(b) to (3)(e), an adjustment must be made to such wholesale market bid yields to maturity to approximate the wholesale market bid yield to maturity that is likely to have been observed had the bonds in question been of the type described in subclause (3)(a).
- (6) Regard may be had, in the absence of information on wholesale market bid yields to maturity on the type of bonds described in subclause (2)(d) that have a remaining term to maturity of-
- (a) in the case of V, each **qualifying debt**; and
 - (b) in the case of X, 5 years,

to the Australian or United States Bloomberg 'BBB' or 'A' fair value curves, or any similar curves published by Bloomberg in respect of Australia or the United States of America, relative to their respective Bloomberg Australian or United States swap curves, treating

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either one of the resulting indicative spreads, when added to the Bloomberg New Zealand swap curve, as the wholesale bid yield to maturity.

SUBPART 6 Incremental rolling incentive scheme

3.6.1 Overview of scheme

The purpose of the incremental rolling incentive scheme is to allow Transpower to receive, for a rolling period of 5 years, the net benefit of any efficiency gains made by it. Such efficiency gains are to be calculated as the difference between actual and forecast controllable operating expenditure for any particular year of the regulatory control period (other than the first year of the first regulatory control period) after deducting the difference in the immediately preceding disclosure year. Both net gains and net losses must be carried forward with losses to be offset against gains up to the point where there are no net gains.

Comment [A38]: Transpower submits that an introductory clause such as this would improve the clarity of this Subpart.

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3.6.2 Calculation of annual incremental changes and adjustment term

- (1) The incremental change for an **opening year** is the difference between **allowed controllable opex** and **actual controllable opex**.
- (2) The incremental change for a disclosure year other than the **opening year** must be determined in accordance with the formula-

$$(\text{allowed controllable opex}_t - \text{actual controllable opex}_t) - (\text{allowed controllable opex}_{t-1} - \text{actual controllable opex}_{t-1}),$$

where-

t means the **disclosure year** in question; and

$t-1$ means the **disclosure year** preceding the **disclosure year** in question.

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- (3) The incremental change for the final **disclosure year** is treated as nil.
- (4) For the avoidance of doubt, nothing in subclause (3) affects subclause 3.6.3.
- (5) Subclauses (1) to (3) are subject to clause 3.6.4.
- (6) The incremental adjustment term is determined-

- (a) in the **opening year** of every **regulatory period** except **RCP1**; and
- (b) in accordance with the formula-

$$(\text{allowed controllable opex}_{t-1} - \text{actual controllable opex}_{t-1}) - (\text{allowed controllable opex}_{t-2} - \text{actual controllable opex}_{t-2}),$$

where

$t-1$ means the final **disclosure year** commencing in the preceding **regulatory period**; and

$t-2$ means the penultimate **disclosure year** commencing in the preceding **regulatory period**.

Comment [A39]: 'assessment period' does not appear to be defined

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3.6.3 Determination of amount to be taken into account as a recoverable cost

- (1) Each incremental change and incremental adjustment term determined in accordance with clause 3.6.1 is notionally carried over from the **disclosure year** in respect of which it is

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determined, subject to clause [3.6.4](#), into each of the subsequent 5 **disclosure years** in nominal terms.

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(2) For the **opening year** of each **regulatory period** after **RCP1**, a net balance must be determined by addition of-

- (a) any incremental changes; and
- (b) the **incremental adjustment term**,

carried into that year from the previous **regulatory period**.

(3) For each **disclosure year** commencing in a **regulatory period** after **RCP1**, other than the **opening year**, a net balance must be determined by addition of-

- (a) any incremental changes carried forward into that year from the preceding **regulatory period**; and
- (b) the incremental adjustment term carried into that year from the **opening year** of that **regulatory period**.

3.6.4 Calculating gains and losses after a catastrophic event

If a price-quality path is amended pursuant to clause [3.7.5](#) by reason of a **catastrophic event**, incremental losses made after the **catastrophic event** are not carried forward to the subsequent 5 **disclosure years**.

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SUBPART 7 Reconsideration of an individual price-quality path

3.7.1 Catastrophic event

Catastrophic event means an event-

- (a) beyond the reasonable control of **Transpower**;
- (b) that could not have been reasonably foreseen **by Transpower** at the time the most recent **IPP determination** was made; and
- (c) in respect of which-
 - (i) action required to rectify its adverse consequences cannot be delayed until a future **regulatory period** without **quality targets** being exceeded in the remaining **disclosure years** of the **regulatory period**;
 - (ii) remediation requires either or both of **capital expenditure** or **operating expenditure** during the **regulatory period**;
 - (iii) the full costs of remediation are not provided for in that **IPP determination**; and
 - (iv) the cost of remediation net of any insurance or compensatory entitlements would have an impact on the price path over the **disclosure years** of the **IPP** remaining on and after the first date at which a remediation cost is proposed to be or has been incurred, by an amount at least equivalent to 1% of the aggregated **forecast MARs** for the **disclosure years** of the **IPP** in which the cost was or will be incurred.

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3.7.2 Change event

Change event means-

- (a) change in a; or
- (b) a new,

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legislative or regulatory requirement applying to **Transpower** the effect of which-

- (c) must take place during the current **regulatory period**;
- (d) is not explicitly or implicitly provided for in the **IPP**; and
- (e) will, over the **disclosure years** of the **IPP** remaining on and after the first date on which the costs to initiate a response to the event are reasonably incurred, have an impact on the price path by an amount at least equivalent to 1% of the aggregated **forecast MARS** for the **disclosure years** of the **IPP** in which costs were or will be incurred.

3.7.3 Error

Error means-

- (a) incorrect data-
 - (i) discovered in an **IPP determination**;
 - (ii) clearly unintended by the **Commission** to be included in it; and
 - (iii) determined by the **Commission, acting reasonably**, to have an impact on the price path of an amount at least equivalent to 1% of the aggregated **allowable revenue** for the **disclosure years** of the **IPP** affected by the incorrect data; or
- (b) incorrect data-
 - (i) relied upon by the **Commission** in making an **IPP determination**;
 - (ii) clearly unintended by the **Commission** to be relied upon in making it; and
 - (iii) determined by the **Commission, acting reasonably**, to have an impact on the price path of a value at least equivalent to 1% of the aggregated **forecast MARS** for the **disclosure years** of the **IPP** affected by the incorrect data.

3.7.4 When price-quality paths may be reconsidered

- (1) **Transpower's IPP** may be reconsidered where-
 - (a) the Commission considers; or
 - (b) **Transpower** satisfies the Commission, upon application, that subclause (2) or (4) applies.
- (2) ~~**Transpower's IPP may be reconsidered by the Commission if the Commission is satisfied, acting reasonably, that-**~~
 - (a) subject to subclause (3), a catastrophic event has occurred;
 - (b) there has been error; or
 - (c) a change event has occurred.
- (3) For the purpose of subclause (2)(a), where the costs to rectify the adverse consequences of a **catastrophic event** are fully covered by-
 - (a) the **IPP** (e.g. through an **operating expenditure** allowance for self-insurance); or
 - (b) commercial insurance held by **Transpower**,the **Commission** will only reconsider the **quality targets**.

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- (4) ~~Transpower's IPP may be reconsidered by the Commission if the Commission is satisfied, acting reasonably, that-~~
- (a) false or misleading information relating to the making of an **IPP determination** has been knowingly-
 - (i) provided by **Transpower** or any of its agents to the **Commission**; or
 - (ii) disclosed pursuant to an **ID determination**; and
 - (b) the **Commission** relied on that information in making an **IPP determination**.
- (5) The **Commission** will reconsider, in each **disclosure year** commencing in a **regulatory period**, subject to subclause (6), save the last, **Transpower's IPP** in respect of the remaining **disclosure years** commencing in the **regulatory period** to take account of-
- (a) the revenue impact of major capex approved by the **Commission**; and
 - (b) an EV adjustment,
- on **forecast MAR**.
- (6) For the purpose of subclause (5)-
- (a) the **Commission** will undertake the reconsideration described in that subclause only in the second and third **disclosure years** of **RCP1**; and
 - (b) 'major capex' and 'EV adjustment' have the same meanings as defined in an **IPP determination**.

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3.7.5 Amending price-quality path after reconsideration

- (1) Where, after reconsidering an **IPP**, the **Commission** determines that it should be amended, the **Commission** may amend either or both of the price path or the **quality targets**, subject to clause 3.7.4(3) and subclauses (2) and (3).
- (2) The **Commission** must not amend the-
- (a) price path more than is reasonably necessary to take account of the change in costs net of any insurance or compensatory entitlements; and
 - (b) **quality targets** more than are reasonably necessary to take into account any necessary change in quality,
- arising from -
- (c) the **catastrophic event**,
 - (d) the **change event**;
 - (e) **error**;
 - (f) the provision of false or misleading information;
 - (g) the amendment required to **forecast MAR** to account for-
 - (i) the revenue impact of major capex approved by the **Commission**; or
 - (ii) an EV adjustment.
- (3) Where the **Commission's** reconsideration of the **IPP** was triggered by a **catastrophic event**, in determining the extent of the amendment required, the **Commission** will consider the extent to which **Transpower** has demonstrated that it has reviewed its **capital expenditure** and **operating expenditure** plans for the remainder of the **regulatory period** and made such substitutions as is possible without adversely affecting its ability to meet the **quality targets**.

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SCHEDULE A STANDARD PHYSICAL ASSET LIVES

Standard Physical Asset Lives for Transpower

ASSET DESCRIPTION	STANDARD PHYSICAL ASSET LIFE (YEARS)
Substations	55
Transformers	55
Oil Containment	45
Switchgear	45
Reactive Power Plant:	
220/110/66 kV Two Zone Bus Protection	15
22/11 kV Neutral Earthing Resistor	45
Transmission Lines	55

[remove, use Transpower's asset lives as used for GAAP]

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