



Alan Jenkins
CEO
Electricity Networks Association
PO Box 1017
Wellington 6140

14 February 2014

Review of Input Methodologies

Dear Alan

We are pleased to attach our report which summarises our findings for Part 1 of our review of the Input Methodologies applying to EDBs, consistent with our agreed scope of work and terms of business dated 12 August 2013.

The Part 1 review addresses technical issues with the IMs, which could be resolved prior to the Commerce Commission's major seven year IM review, which is scheduled to commence in 2015.

Part 2 of our review is to address the CPP IM, drawing largely on the experience of Orion during its recent CPP application and assessment. Our Part 2 report will follow shortly.

Our report is subject to the restrictions set out in Attachment A.

As discussed, a copy of this report is to be forwarded to the Commission for their consideration.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Lynne Taylor'.

Lynne Taylor
Director
Consulting
lynne.taylor@nz.pwc.com
T: 09 355 9573

A handwritten signature in black ink, appearing to read 'Craig Rice'.

Craig Rice
Partner
Consulting
craig.rice@nz.pwc.com
T: 09 355 8641

cc:

John McLaren, Chief Advisor, Regulation Branch, Commerce Commission
Nick Russ, Chief Advisor, Regulation Branch, Commerce Commission



Review of IMs – issues and suggested solutions

ENA IM Review

Scope of Work

There is a major review of the IMs scheduled to commence in 2015-2016. Prior to that there may be an opportunity to refine a number of IM clauses to correct errors and remove ambiguity. We note that some of the recent refinements made to the IMs, and the introduction of the 2012 IDD have compromised the integrity of the regulatory rules to some extent. These issues lead to practical problems for EDBs in applying the IMs and the IDD. Accordingly, the ENA has commissioned a review of the IMs with a view to identifying and resolving these issues with the Commission.

This review does not raise issues or suggest changes to the policy intent of the current IMs.

IDD and DPP IMs

We have identified a number of errors, inconsistencies and ambiguities since the IMs were introduced, and as a result of subsequent amendments. The recent IDD determination has also introduced further ambiguity in how the IMs are to be implemented in practice.

This paper collates together a set of issues with the IMs, and in some cases the interface with the IDD, with appropriate explanations and justifications. This paper also includes suggested solutions for each of the issues identified.

This paper does not include suggested refinements to the CPP IMs (other than those which arise from inconsistencies with other IMs, or minor technical issues). A further paper is being prepared which comprises a comprehensive review of the CPP IM, which is largely influenced by the Orion CPP experience.

Topics addressed

The attached paper includes suggested IM changes which are broadly grouped under the following five headings:

- A. Inconsistencies
- B. Errors
- C. Ambiguities
- D. Unintended practice
- E. Potential improvements

Potential Impact of Suggested Amendments

The following table identifies where the suggested amendments impact on DPP MAR and IDD ROI, and the anticipated materiality of the proposed change (either high or low). Those issues which may impact DPP MAR, or IDD ROI are, in our view, those of greater importance for immediate resolution.

Item	Impact on DPP MAR	Impact on IDD ROI
Inconsistencies		
1. Definition of regulatory profit/(loss) before tax - for the purpose of calculating the regulatory tax allowance IM 2.3.1(4), IM 4.3.1(4), IM 5.3.13(4)	-	High
2. Definition of notional deductible interest IM 2.3.4(2), IM 4.3.3(2), IM 5.3.16(2)	High	High
3. Definition of notional net cash flows IM 5.3.2(1), IDD Schedule 16	High	High
4. TCSD timing assumptions in ROI and BBAR formulae IM 5.3.2(1), IDD Schedule 16	-	Low
5. Allowance for RAB disposals but not tax disposals in DPP IM 4.2.6, IM 4.3.5(3)(c)	Low	
Errors		
6. Deferred tax is not adjusted for asset disposals IM 2.3.7(2), IM 4.3.4(2), IM 5.3.19(2)	Low	Low
7. Regulatory tax asset value of new assets acquired from a related party is limited to the value of commissioned assets IM 2.3.9(3)(c)(ii), IM 5.3.21(3)(c)(ii)	Low	Low
8. DPP asset life for additional assets is one year less than what was likely envisaged IM 4.2.2(3)(b)	High	-
9. Definitions in DPP IMs of base year RAB roll-forward values are internally inconsistent IM 4.2.1(2)(a), IM 4.2.1(3)(a), IM 4.2.2(2)(a)(i), IM 4.2.3 (2)(a). IM 4.2.5, IM 4.2.6	High	-
10. Definition of 'result of asset allocation ratio' is inconsistent with what it is used for IM 2.3.9(1) and (4), IM 5.3.21 (1) and (4)	Low	Low

Item	Impact on DPP MAR	Impact on IDD ROI
11. The information required in a CPP proposal for 'amortisation of revaluations' includes information which is irrelevant for calculating the value of amortisation of revaluations IM 5.4.23	-	-
12. A CPP proposal is required to include information on unamortised initial differences in asset values by asset category. However, this item is not naturally separable by asset category IM 5.4.22(1)	-	-
13. Exclusion from recoverable costs of transmission charges for exempt EDBs IM 3.1.3(1)(b)	-	High
14. Use of the term 'related company' IM 5.4.14	-	-
15. Regulatory investment value is not defined for ID IM 2.3.4	-	High
Ambiguities		
16. Are tax asset disposals limited to RAB disposals? IM 2.3.9, IM 5.3.21, IDD Schedule 16	-	Low
17. Definition of weighted average remaining useful life of relevant assets, as used for the amortisation of initial differences IM 2.3.5(1), IM 4.3.3(3), 5.3.17(1)	Low	Low
18. Definition of asset (RAB) disposals IM 1.1.4	-	High
19. When assets are transferred from one regulated supplier to another, how are depreciation and revaluation to be recorded in the year of transfer? IM 2.2.11(e) and IM 5.3.11 (e)	High	High
20. Remaining asset lives for acquired assets IM 2.2.8, IM 1.1.4	High	High
21. Tax adjustments for acquisitions and disposals IM 2.3.5(4), IM 2.3.7(3) and (4), IM 5.3.17(4), IM 5.3.19(3) and (4)	Low	Low
22. How to determine the TCSD when debt is issued at the group level IM 2.4.9(1) and (2), IM 5.3.30 (1) and (2)	Low	Low

Item	Impact on DPP MAR	Impact on IDD ROI
23. Inclusion of avoided transmission charges from notional embedded generators as recoverable costs IM 3.1.3(1)(f)	-	Low
24. Treatment of losses on disposal IM 1.1.4	Low	Low
25. The appropriate treatment of intercompany revenues in the cost allocation materiality revenue-threshold test IM 2.1.2(2)(a)	Low	Low
26. Definition of interest rate swap IM 2.4.9(3)(a), IM 5.3.30(3)(a)	-	-
27. Definition of 'most recently' when referring to an EDB's audited financial statements for ID IM 2.4.9(2)	-	-
Unintended practice		
28. The definition of finance leases IM 1.1.4, IM 3.1.3(c)	Low	Low
29. The Bloomberg NZ 'A' fair value curve, for use in TCSD, has been discontinued IM 2.4.10(2)(a) and IM 5.3.31(2)(a)	Low	Low
Potential improvements		
30. Related party transaction rules IM 2.2.11(5) & IDD 2.3.6(1)	High	High
31. Method for adjusting CPP BBAR for the value of claw-back IM 5.3.4(1)	-	-
32. Revaluations information in a CPP proposal is incomplete IM 5.4.13	-	-
33. Specification of ID requirements considered for asset adjustment process IM 2.2.1(4)(a)(ii)	-	-
34. Specification of standard physical asset lives IM 2.2.8, Schedule A	High	High
35. The use of an engineer to determine the physical asset life for non-system assets IM 2.2.8(1)(e)(v)	Low	Low



Inconsistencies

Items where the methods are inconsistent across the different types of regulation

1. **Definition of regulatory profit/(loss) before tax - for the purpose of calculating the regulatory tax allowance**
IM 2.3.1(4), IM 4.3.1(4), IM 5.3.13(4)
 - One of the inputs to the calculation of the regulatory tax allowance is regulatory profit/(loss) before tax. Each of the ID, DPP and CPP IMs includes a different definition for this term, while the 2013 ID spreadsheet template reflects another definition, as follows (differences in **bold**):
 - ID (IM 2.3.1(4)) defined with reference to IDD
 - IDD (Schedule 16)
= (total regulatory income – pass-through and recoverable costs) – opex – total depreciation + **total revaluations**
 - ID (Schedule 3 template spreadsheet)
= (total regulatory income – pass-through and recoverable costs) – opex – total depreciation + **total revaluations – TCSD**
 - DPP (IM 4.3.1(4)):
= (allowable revenue + other regulated income) – opex – total depreciation – **TCSD**
 - This formula is also inconsistent with the corresponding DPP formula in the GDB IMs. The formula in the GDB IMs does not deduct TCSD.
 - CPP (IM 5.3.13(4)):
= (BBAR + other regulated income) – opex – total depreciation
 - For the purpose of calculating the regulatory tax allowance, regulatory profit should be determined in the same way across all forms of regulation. The current DPP definition (as stated above) is appropriate.
 - TCSD is a cost that should be deducted from revenue, in the same way that opex is.
 - Revaluations are not taxable, and hence should not be included in regulatory profit when determining the tax allowance.
 - Therefore suggest that the ID definition of regulatory profit/(loss) before tax is amended to remove the revaluation term and include the TCSD term.
 - The CPP IM term requires the TCSD term to be included.
2. **Definition of notional deductible interest**
IM 2.3.4(2), IM 4.3.3(2), IM 5.3.16(2)
 - Each of the ID, DPP and CPP IMs includes a different definition of notional deductible interest (differences in **bold**).



- ID (IM 2.3.4(2)):
= (regulatory investment value x leverage x cost of debt) + TCSD
- DPP (IM 4.3.3(2)):
= (**opening investment value** x leverage x cost of debt) + TCSD
 - opening investment value is defined as the equivalent to regulatory investment value
- CPP (IM 5.3.16(2)):
= ((regulatory investment value + **RAB proportionate investment**) x leverage x cost of debt) + TCSD
- This discrepancy between CPP and ID/DPP has been created by the inconsistent timing assumptions and cash-flow formulae used in each of the regulatory methods (refer to other items below).
- Suggest making the definitions consistent across the three forms of regulation.
- Suggest that it is appropriate to add RAB proportionate investment to regulatory investment value. This will account for the notional interest tax shield created by commissioned assets in the year in which they are commissioned. Hence, suggest that the ID and DPP definitions be amended to be consistent with the CPP definition.
- A second issue is that each of the formulae above are inconsistent with the corresponding formula in the GDB IMs. The formulae in the GDB IMs additionally divide the formulae stated above by “the square-root of (1 + cost of debt)”.
- Suggest that the EDB and GDB formulae should be consistent.
- Suggest that it is not appropriate to divide the current formulae by ‘the square-root of (1 + cost of debt)’, and hence that the GDB definitions be amended to make them consistent with the EDB definitions.
 - Since the timing of the interest payments during the year do not affect the end-of-year tax liability, it does not seem appropriate to adjust the value downward (by “the square-root of (1 + cost of debt)”) for the purposes of determining the regulatory tax allowance. The tax building block already has timing assumptions applied to it in the BBAR and ROI formulae; making an additional timing adjustment to notional deductible interest involves an unnecessary ‘double-adjustment’.

3. Definition of notional net cash flows IM 5.3.2(1), IDD Schedule 16

- The definition of notional net cash flows in the IDD is different from the definition which underlies the CPP BBAR formula.
 - ID (IDD Schedule 16, ‘notional net cash flows’ - used in the IDD ROI formula):
= (total regulatory income – pass-through and recoverable costs) – opex – regulatory tax allowance – value of commissioned assets + **value of asset disposals**



- CPP (IM 5.3.2(1)) (underlying formulae specified in Nov 2012 Reasons Paper for CPP IM amendment, which was used to derive the BBAR formula (IM 5.3.2(1))):
= (BBAR + other regulated income) – opex – regulatory tax allowance – value of commissioned assets – **TCS**D – **change in deferred tax**
- Suggest making these definitions consistent.
- The appropriate definition of notional net cash flows is:
 - = ‘total distribution revenue’ – opex – regulatory tax allowance – value of commissioned assets – TCSD
 - That is, TCSD should be deducted from revenues, but not the change in deferred tax, and the value of disposals should not be added back.
 - TCSD reflects an outgoing cash flow that should be deducted from revenue, in just the same way that opex is.
 - The RAB value of disposals does not reflect a cash flow amount, and should not be a part of this formula.
 - The tax element of notional net cash flows should reflect (notional) tax paid, and the regulatory tax allowance is the best reflection of that. The change in deferred tax is appropriately included in the ROI and BBAR formulae as one of the differences between opening and closing asset values – including it again as a cash flow is double-counting.
- Therefore suggest that the definition of notional net cash flows in the IDD be amended such that the value of disposals is not deducted.
- Suggest that the formula for BBAR in the CPP IMs be amended such that the ‘change in deferred tax’ term is multiplied by “-1” not “TF-1”. Also suggest that the formula used in the DPP reset preliminary financial model be amended in the same way.

4. **TCS**D timing assumptions in ROI and BBAR formulae IM 5.3.2(1), IDD Schedule 16

- The timing assumption for TCSD implied by the ROI formula in the IDD (Schedule 16, ‘year end ROI comparable to a vanilla WACC’) is different from that implied by the BBAR formula specified in the CPP IM (IM 5.3.2(1)) (and the similar formula used in the DPP reset preliminary financial model).
- TCSD is assumed to occur at the end of the year in IDD, but at mid-year (ie evenly over the year) in CPP and DPP.
- There is no logic for this difference. Suggest that the timing assumptions be made consistent.
- Suggest that TCSD be assumed to occur mid-year across all regulation, since it is a cost that is incurred throughout the year. Therefore suggest that the ID ROI formula be amended such that TCSD is deducted from the mid-year cash flows rather than the end-of-year asset values.



5. Allowance for RAB disposals but not tax disposals in DPP
IM 4.2.6, IM 4.3.5(3)(c)

- The DPP IMs provide for an allowance for RAB disposals (with the forecast to be determined by the Commission - IM 4.2.6). However, the DPP regulatory tax asset roll-forward does not allow for tax disposals (IM 4.3.5(3)(c)). This is inconsistent.
- Suggest amending the definition of 'total closing regulatory tax asset value' (IM 4.3.5(3)(c)) to include allowance for tax disposals and a method for forecasting these.
- Refer to issue 16. below, for further discussion as to how tax disposals are to be defined.

Errors

Items where the method is wrong or doesn't work

6. Deferred tax is not adjusted for asset disposals
IM 2.3.7(2), IM 4.3.4(2), IM 5.3.19(2)

- The deferred tax balance is not adjusted for asset disposals in either the ID IMs (IM 2.3.7(2)), DPP IMs (IM 4.3.4(2)) or the CPP IMs (IM 5.3.19(2)).
 - However, the spreadsheet template in the IDD used to calculate closing deferred tax (Schedule 5) includes an adjustment for disposals. The spreadsheet template for the transitional financial information (Schedule 5h) does not include this adjustment.
- Since the deferred tax balance is adjusted for acquired assets, it seems appropriate to adjust it for RAB disposals as well.
- Suggest that deferred tax includes an adjustment for RAB disposals:
 - The formulae in the definitions for closing deferred tax in the ID IMs (IM 2.3.7(2)), and the CPP IMs (IM 5.3.19(2)) is amended as follows (new text in **bold**):
$$= \text{opening deferred tax} + \text{tax effect of temporary differences} - \text{tax effect of amortisation of initial differences} + \text{deferred tax balance relating to assets acquired in the disclosure year in question} - \text{deferred tax balance relating to assets disposed of in the disclosure year in question} + \text{cost allocation adjustment}$$
 - The formula in the DPP IMs (IM 4.3.4(2)) is amended as follows (new text in **bold**):
$$= \text{opening deferred tax} + \text{tax effect of temporary differences} - \text{tax effect of amortisation of initial differences} - \text{deferred tax balance relating to assets disposed of in the disclosure year in question}$$
 - New clauses are also added to define this new term similar to the existing definitions (in IM 2.3.7(3), and IM 5.3.19(3)) for the adjustment for acquired assets



7. Regulatory tax asset value of new assets acquired from a related party is limited to the value of commissioned assets

IM 2.3.9(3)(c)(ii), IM 5.3.21(3)(c)(ii)

- When assets are acquired from a related party, their notional tax asset value upon commissioning, which is used to determine its starting regulatory tax asset value (RTAV), cannot be greater than the value of commissioned assets for those assets (IM 2.3.9(3)(c)(ii) and IM 5.3.21(3)(c)(ii)).
- It is appropriate that any related party restrictions that apply to the value of a commissioned asset (under IM 2.2.11(5) and IM 5.3.11(6)) also apply to that asset's starting RTAV.
- However, there may be reasons why the starting tax asset value is appropriately higher than the value of commissioned asset, without compromising other regulatory methods (eg RAB).
- In particular, if an EDB elects to treat capital contributions as income for tax purposes (ie under section CG 8 of the Income Tax Act 2007), the opening tax asset value for an asset to which capital contributions were collected for will be higher than the value of the commissioned asset – the value of commissioned assets will be reduced by capital contributions but the tax asset value will not. It is not reasonable to reduce the RTAV in this case.
- Suggest that IM 2.3.9(3)(c)(ii) and IM 5.3.21(3)(c)(ii) be amended as follows (new text in **bold**):
 - “limited to its value of commissioned asset, **unless the EDB treats capital contributions under section CG8 of the Income Tax Act 2007, in which case it is limited to its value of commissioned asset plus any capital contributions applicable to the asset which are included in the tax asset value**”.

8. DPP asset life for additional assets is one year less than what was likely envisaged

IM 4.2.2(3)(b)

- The DPP IMs Reasons Paper (para 55.2) specifies that additional assets (as defined in Part 1 of the IMs) are depreciated using a 45-year asset life.
- However the DPP IMs (IM 4.2.2(3)(b)) defines ‘remaining asset life for additional assets’ such that these assets are depreciated over 44 years. For example, the remaining asset life in the disclosure year after the commissioning date is defined as equal to 45 less 1.
- Note also that the 2012 DPP reset models use an asset life of 45 years, and hence are inconsistent with the IMs.
- Suggest that the definition of ‘remaining asset life for additional assets’ therefore be revised accordingly:
 - IM 4.2.3(3)(b) is amended as follows (new text in **bold**):



- “ ‘remaining asset life for additional assets’ for a disclosure year means 45 years less the number of disclosure years from the disclosure year for which the forecast aggregate value of commissioned assets for the relevant additional assets is determined to the **disclosure year preceding the disclosure year** in question.”

9. Definitions in DPP IMs of base year RAB roll-forward values are internally inconsistent IM 4.2.1(2)(a), IM 4.2.1(3)(a), IM 4.2.2(2)(a)(i), IM 4.2.3 (2)(a). IM 4.2.5, IM 4.2.6

- Base year values for aggregate opening RAB (IM 4.2.1(2)(a)), depreciation (IM 4.2.2(2)(a)(i)) and aggregate closing RAB (IM 4.2.1(3)(a)) are all sourced from information disclosures.
- However, the base year value for revaluations (IM 4.2.3(2)(a)) is calculated using a simplified method, meaning the value will differ from that disclosed. In addition, the base year values for commissioned and disposed assets (IM 4.2.5-4.2.6) are subject to the Commission’s discretion.
- This means that the base year value for aggregate closing RAB will not equal the result of the RAB roll-forward formula: aggregate closing RAB = aggregate opening RAB – depreciation + revaluations + commissioned assets – disposed assets.
- To make these definitions internally consistent, either:
 - the definitions of revaluations, commissioned assets and disposed assets need to be revised so that the base year values for each of these are sourced from information disclosures; or
 - the definition of aggregate closing RAB need to be amended such that the base year value is the result of the RAB roll-forward formula, rather than being sourced from information disclosures.
- Suggest that the latter of the above two options be adopted.
- Suggest that IM 4.2.1(3) be amended as follows (new text in **bold**):
 - “Aggregate closing RAB value for existing assets means, for-
 - (a) the base year, ~~the sum of each ‘closing RAB value’ for all assets calculated in accordance with Part 2 for that disclosure year;~~ **the value determined in accordance with the formula-**
aggregate opening RAB value for existing assets – depreciation for existing assets + revaluation for existing assets + aggregate value of commissioned assets – aggregate value of disposed assets
 - and
 - (b) each disclosure year thereafter, the value determined in accordance with the formula-



aggregate opening RAB value for existing assets – depreciation for existing assets + revaluation for existing assets – forecast aggregate value of disposed assets”

- The separate formula is necessary for the base year because existing assets is defined (in Part 1 of the IMs) as assets that have a closing RAB value in the base year, and hence assets commissioned in the base year are included in existing assets.

10. Definition of ‘result of asset allocation ratio’ is inconsistent with what it is used for IM 2.3.9(1) and (4), IM 5.3.21 (1) and (4)

- The ‘result of asset allocation ratio’ is determined for each regulatory tax asset, and is multiplied by the tax asset value to determine the regulatory tax asset value. Hence the ‘result of asset allocation ratio’ needs to be a number between 0 and 1 or equal to 1.
- However, only one of the two methods specified to determine the value results in a number of 1 or less than 1. The method specified for a situation where the asset maintained under the tax rules does not have a matching asset in the RAB results in a number considerably higher than 1.
- Either the definition of ‘result of asset allocation ratio’ needs to be changed such the result is always a number between 0 and 1, or the formula which uses this value needs to be changed to compensate. The latter is more straightforward.
- The following changes to the IMs are required:
 - IM 2.3.9(1) and IM 5.3.21(1) are amended as follows (new text in **bold**):
 - “Regulatory tax asset value, in relation to an asset, means-
 - (a) **where an asset or group of assets maintained under the tax rules has a matching asset or group of assets maintained for the purpose of Subpart 2, the value determined in accordance with the formula-**
$$\text{tax asset value} \times \text{result of asset allocation ratio}; \text{ and}$$
 - (b) **where an asset or group of assets maintained under the tax rules does not have a matching asset or group of assets maintained for the purpose of Subpart 2, the value of the asset allocated to the supply of electricity distribution services were clause 2.1.1 to apply to the asset or group of assets.”**
 - and IM 2.3.9(4) and IM 5.3.21(4) are amended as follows:
 - “For the purpose of subclause (1), ‘result of assets allocation ratio’ means, ~~where an asset or group of assets maintained under the tax rules-~~



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

opening RAB value or sum of opening RAB values, as the case may be

÷

unallocated opening RAB value or sum of unallocated opening RAB values, as the case may be,

applying the formula in respect of the asset or smallest group of assets maintained for the purpose of Subpart 2 that has a matching asset or group of assets maintained under the tax rules; and

~~(b) — does not have a matching asset or group of assets maintained for the purpose of Subpart 2, the value of the asset allocated to the supply of electricity distribution services were clause 2.1.1 to apply to the asset or group of assets.”~~

11. The information required in a CPP proposal for ‘amortisation of revaluations’ includes information which is irrelevant for calculating the value of amortisation of revaluations IM 5.4.23

- A CPP proposal is required to include the following values under the heading ‘amortisation of revaluations information’ (IM 5.4.23):
 - unamortised balance of revaluations to date
 - adjusted depreciation
 - average weighted remaining useful life of the assets used to determine the amortisation of revaluations
 - particulars of how the weighted average remaining useful life was calculated.
- However, of these four items, only adjusted depreciation is relevant for calculating amortisation of revaluations.
- Amortisation of revaluation is calculated as the difference between total depreciation and adjusted depreciation (IM 5.3.18). It does not involve a remaining useful life, or a balance which is rolled forward.
- Since total depreciation is required with the RAB information (IM 5.4.12), the only relevant information required for amortisation of revaluations is values for adjusted depreciation.
- Suggest that IM 5.4.23 be amended so that the only information required under this clause be values for adjusted depreciation.



12. A CPP proposal is required to include information on unamortised initial differences in asset values by asset category. However, this item is not naturally separable by asset category
IM 5.4.22(1)

- A CPP proposal is required to include values for opening amortised initial differences in asset values by asset category (IM 5.4.22(1)).
- Initial differences in asset values is defined at an aggregate level (IM 5.3.17). It is not defined as the sum of the initial difference for each asset. The roll-forward of the balance as it is amortised occurs at an aggregate level, not at an individual asset level.
- The initial difference in asset values (at the start of FY10) cannot easily be separated into asset categories, as it is not common to have a one-to-one mapping of assets between RAB and regulatory tax asset registers.
- It is even more difficult to separate the unamortised balance in later years in asset categories because of the aggregate nature of the roll-forward and the use of one aggregate weighted average useful life.
- Suggest that the requirement for this information to be provided at an asset category level is removed, and that aggregate information be required for the amortisation of initial differences in asset values.

13. Exclusion from recoverable costs of transmission charges for exempt EDBs
IM 3.1.3(1)(b)

- The definition of the recoverable cost in respect of transmission charges (IM 3.1.3(1)(b)) includes a reference to non-exempt EDBs. This creates confusion, particularly when applying these recoverable costs for ID purposes.
- Suggest that the word “non-exempt” be removed from IM 3.1.3(1)(b), and the IDD spreadsheet template for Schedule 3(ii).

14. Use of the term ‘related company’
IM 5.4.14

- IM 5.4.14 uses the term “related company” in four places. This term is not defined.
- Suggest that references to “related company” in IM 5.4.14 be replaced by “related party”.

15. Regulatory investment value is not defined for ID
IM 2.3.4

- ‘Regulatory investment value’ is used in the definition of notional deductible interest (eg in IM 2.3.4(2), which is in turn used as part of the ‘regulatory tax adjustments’.
- The ID IMs define ‘regulatory investment value’ in terms of the value determined in accordance with the applicable ID determination (IM 2.3.4(3)). However, the current IDD does not define regulatory investment value.



- Suggest that IM 2.3.4(3) be amended to define ‘regulatory investment value’ as the sum of total opening RAB value and opening deferred tax. This is consistent with the definition in the CPP IMs (IM 5.3.2(2)).

Ambiguities

Items where the IMs do not give sufficient guidance

16. Are tax asset disposals limited to RAB disposals? IM 2.3.9, IM 5.3.21, IDD Schedule 16

- It is unclear whether assets can be disposed of for regulatory tax asset purposes when they are not disposed of from the RAB, particularly for ID purposes.
- The IMs suggest that tax disposals are not limited to assets removed from the RAB (IM 2.3.9, IM 5.3.21). This seems reasonable.
 - The definition of RAB disposals is different from the definition of tax asset disposals used by the IRD, and since the regulatory tax asset value for a given asset is based on its tax asset value, it seems reasonable to allow an asset to be disposed of for tax purposes where it meets the IRD’s definition of a disposal even if it does not meet the definition of RAB disposal.
- However the IDD (Schedule 16) suggests that you can only dispose of an asset for tax purposes if you also remove it from the RAB. It defines the ‘regulatory tax asset value of asset disposals’ as “the sum of regulatory tax asset values for assets that have a value in asset disposals” (emphasis added).
- The IMs specify the method used for determining tax asset disposals. But the IDD does not implement this method correctly. Suggest the IDD is amended such that it correctly implements the method specified in the IMs.

17. Definition of weighted average remaining useful life of relevant assets, as used for the amortisation of initial differences IM 2.3.5(1), IM 4.3.3(3), 5.3.17(1)

- A value for the ‘weighted average remaining life of relevant assets’ is required in order to determine the value for amortisation of initial differences in asset values (IM 2.3.5(1), IM 4.3.3(3), IM 5.3.17(1)).
- However, the IMs do not define this term. The DPP IMs define it, but only by reference to the value disclosed under IDD.
- In particular, they do not define “useful life”, “relevant assets”, the weights to use, or how the value of the term should change over time.
 - The IM Reasons Paper implies that it was envisaged that this value would reduce by exactly one each year (paras 5.3.11, G2.37). However, this is not clear from the IM text, and requires a reading of the Reasons Paper.



- While it seems clear that ‘relevant assets’ means assets included in the calculation of initial differences, this is not specific enough, because the initial RAB and initial regulatory tax asset values may not be comprised of exactly the same set of assets.
- The IMs do not state which weights to use. The IDD specifies that the initial differences for each asset are used as weights for ID purposes, but this is difficult in practice without asset to asset mapping between the RAB and regulatory tax asset registers.
- Suggest that this term be defined more precisely. Suggest that:
 - relevant assets be defined as those in the initial RAB
 - remaining asset lives be weighted by opening RAB values
 - That is, ‘weighted average remaining useful life of relevant assets’ be defined in both the ID and CPP IMs as follows (either in Part 1 of the IMs or in new clauses within the ID and CPP IMs):

“means the weighted average remaining asset life of assets with an initial RAB value, calculated by using the initial RAB values as weights.”
 - Note that this is the definition used for the s53ZD information request in May 2011 for the 2012 DPP reset (refer ‘Instruction 5’ on the spreadsheet template).

18. Definition of asset (RAB) disposals

IM 1.1.4

- ‘Disposed asset’ is defined in Part 1 of the IMs as an asset that has been (or, for CPP purposes, is forecast to be) sold or transferred, or has been irrecoverably removed from the EDB’s possession without consent but is not a lost asset.
- There has been some uncertainty as to what types of ‘disposal’ can be removed from the RAB. For example, whether assets sold for a nominal amount (ie sold for scrap) qualify as RAB disposals.
- Suggest that the IMs make the definition more specific, particularly the term ‘sold’.

19. When assets are transferred from one regulated supplier to another, how are depreciation and revaluation to be recorded in the year of transfer?

IM 2.2.11(e) and IM 5.3.11 (e)

- The ID and CPP IMs include inconsistent treatment of RAB values when assets are transferred from one regulated supplier to another. Acquisitions are included in the definition of ‘commissioned assets’.
- In the acquirer’s regulatory asset register:
 - The ‘value of commissioned asset’ for an acquired asset is equal to the opening RAB value for that asset on the day before the commissioning date (in the vendor’s



- regulatory accounts) (IM 2.2.11(e), IM 5.3.11(1)(e)). This means that it is the opening RAB value for that year, as the IMs provide for no partial year RAB roll forward.
- Depreciation and revaluations are not calculated for commissioned assets in the year they are commissioned. The closing RAB value for an asset commissioned in that year is equal to its commissioning value, in this case its acquisition value.
 - In the vendor's regulatory asset register, a full year of depreciation is recorded. No revaluations are recorded.
 - The vendor must account for depreciation on the asset in the year of transfer (IM 2.2.5, IM 5.3.7). Under the EDB IMs, revaluations on a disposed asset are nil (IM 2.2.9(3)(b)(i), IM 5.3.10(3)(b)(i)).
 - It is inappropriate for the closing RAB in the acquirer's asset register not to be adjusted for the depreciation made by the vendor. This has the effect of over-depreciating the asset over its total life. In addition, currently the asset is not revalued in the year of transfer/sale.
 - Suggest that the value of commissioned asset for the acquirer be determined as the closing RAB value in the vendor's asset register had the asset not been transferred.
 - That is, suggest that IM 2.2.11(e) and IM 5.3.11(e) be amended such that the value of commissioned asset for an asset acquired from another regulated supplier is equal to the closing RAB value had the asset not been acquired (determined using the IMs that apply to the vendor).

20. Remaining asset lives for acquired assets IM 2.2.8, IM 1.1.4

- The method for determining the remaining asset life for an acquired asset is not explicitly defined.
 - It is not explicitly clear whether the remaining asset life, as applied by the acquirer, should reflect the period of time since the assets were commissioned by the vendor (ie the remaining asset life is transferred along with the RAB value) or whether the amount remaining is determined from the commissioning date for the acquirer (ie the asset life is 'reset' upon transfer). The former seems appropriate.
- A question on this topic was included in the IDD issues register. The answer given stated that an EDB should adopt the remaining asset life that would have been used by the vendor. While that seems reasonable, neither the IMs nor the IDD explicitly say this.
- Suggest that the IMs be amended to clarify that, when assets are acquired from another regulated party, the acquirer should adopt the remaining asset life that would have been used by the vendor.
- The situation where assets are acquired from an unregulated party requires separate specification, because the unregulated party would not necessarily have a remaining asset life which can be adopted. Suggest that when assets are acquired from an unregulated party, the



remaining asset life should be determined by applying the remaining asset life for similar assets already in the RAB which were commissioned in the same year.

- Where assets are not already in the RAB, the remaining life may be assessed, as per IM 2.2.8 (1)(e)(v), although it is noted that an engineer may not be required for all classes of assets.
- Suggest that the IMs be amended to reflect this.

21. Tax adjustments for acquisitions and disposals
IM 2.3.5(4), IM 2.3.7(3) and (4), IM 5.3.17(4), IM 5.3.19(3) and (4)

- When an asset is acquired from another regulated supplier, any applicable unamortised initial differences or deferred tax is also acquired. Similarly, when an asset is disposed of, any applicable unamortised initial differences or deferred tax is also disposed of.
- However, the appropriate formula for the adjustments to initial differences is not explicitly set out.
 - IM 2.3.5(4) and IM 5.3.17(4) state that an adjustment for initial differences must be made, but these clauses do not specify the method to be used. The IM Reasons Paper (para G2.15) states that the adjustment should be based on the amount of unamortised initial differences in the vendor's regulatory tax balances, but does not specify the method.
 - It is unclear how to separate the unamortised value of one asset from the wider aggregate – in particular, whether this calculation should make some adjustment for differences between the remaining asset life of the transferred asset and the weighted average remaining asset life used for the amortisation.
 - It is also unclear whether the weighted average remaining asset life in the acquirer's regulatory tax balances should be adjusted as a result of the transfer (and if so, how), or just the unamortised value.
- The method for the adjustment to the deferred tax balance for acquisitions is set out in more detail than for the initial differences (IM 2.3.7(3) and (4) and IM 5.3.19(3) and (4)). However, this adjustment could be described in terms of a formula, rather than simply what has to be taken into account.
- Suggest that the IMs specify a prescriptive method, with the formulae to be used, for all adjustments to initial differences and deferred tax in response to acquisitions and disposals, as follows:
 - Deferred tax balance relating to assets acquired in disclosure year
 - (1) Deferred tax balance relating to assets acquired in disclosure year = tax effect of depreciation temporary differences of acquired assets - tax effect of amortisation of initial differences of acquired assets
 - (2) For the purpose of subclause (1)-



- (i) 'depreciation temporary differences of acquired assets' is determined in accordance with the formula-

the sum of adjusted depreciation of assets acquired in disclosure year from the disclosure year 2010 until the acquisition date - the sum of tax depreciation of assets acquired in disclosure year from the disclosure year 2010 until the acquisition date
 - (ii) 'amortisation of initial differences of acquired assets' is determined in accordance with the formula-

the sum of amortisation of initial differences of assets acquired in disclosure year from the disclosure year 2010 until the acquisition date
- Deferred tax balance relating to assets disposed of in disclosure year
 - (1) Deferred tax balance relating to assets disposed of in disclosure year = tax effect of depreciation temporary differences of disposed assets - tax effect of amortisation of initial differences of disposed assets
 - (2) For the purpose of subclause (1)-
 - (i) 'depreciation temporary differences of disposed assets' is determined in accordance with the formula-

the sum of adjusted depreciation of assets disposed in disclosure year from the disclosure year 2010 until the disposal date - the sum of tax depreciation of assets disposed in disclosure year from the disclosure year 2010 until the disposal date
 - (ii) 'amortisation of initial differences of disposed assets' is determined in accordance with the formula-

the sum of amortisation of initial differences of assets disposed in disclosure year from the disclosure year 2010 until the disposal date
- Unamortised balance of assets acquired in disclosure year
 - (1) adjustment for unamortised initial differences in acquired assets is determined in accordance with the formula-

initial differences in acquired assets - amortisation of initial differences in acquired assets from disclosure year 2010 to acquisition date
 - (2) for the purpose of subclause (1), 'initial differences in acquired assets' means the sum of initial RAB values of the acquired assets less the sum of the regulatory tax asset values on the first day of disclosure year 2010.



- (3) For the purpose of subclause (1), 'amortisation of initial differences in acquired assets from disclosure year 2010 to acquisition date' is determined in accordance with the formula-

(initial differences in acquired assets / weighted average remaining useful life of acquired assets on the first day of disclosure year 2010) x the number of years from the disclosure year 2010 to the acquisition date

- o Unamortised balance of assets disposed of in disclosure year

- (1) adjustment for unamortised initial differences in disposed assets is determined in accordance with the formula-

initial differences in disposed assets - amortisation of initial differences in disposed assets from disclosure year 2010 to disposal date

- (2) for the purpose of subclause (1), 'initial differences in disposed assets' means the sum of initial RAB values of the disposed assets less the sum of the regulatory tax asset values on the first day of disclosure year 2010.

- (3) for the purpose of subclause (1), 'amortisation of initial differences in disposed assets from disclosure year 2010 to disposal date' is determined in accordance with the formula-

(initial differences in disposed assets / weighted average remaining useful life of disposed assets on the first day of disclosure year 2010) x the number of years from the disclosure year 2010 to the disposal date

22. How to determine the TCSD when debt is issued at the group level

IM 2.4.9(1) and (2), IM 5.3.30 (1) and (2)

- The TCSD is determined using information about 'qualifying debt' issued by a 'qualifying supplier' (IM 2.4.9(1) and (2), IM 5.3.30(1) and (2)).
- A qualifying supplier is defined as (i) a regulated supplier (ie supplier of regulated goods and services), (ii) which has a weighted average original tenor of more than 5 years as at the date of that supplier's most recently published audited financial statements (IM 2.4.9(2), IM 5.3.30(2)).
- However, many EDBs prepare audited financial statements and issue debt at the 'group' level, not the EDB level. It is unclear whether an 'EDB group' (ie an entity which has an EDB as a subsidiary) is to be classified as a qualifying supplier, and hence whether TCSD applies to EDBs which issue debt at the group level.
- Note that a question on this topic was included in the IDD issues register. In response, it was noted that a regulated supplier could include subsidiaries, but there was no mention of entities above the EDB. In addition, the response stated that the TCSD should "include only the assets used to provide the regulated services". This is irrelevant since TCSD is not defined in terms of assets but rather in terms of debt and the debt is not directly linked to specific assets.



- Suggest that either:
 - the definition of a regulated supplier be amended to include entities for which an EDB is a subsidiary, or
 - the definition of a qualifying supplier be amended to recognise that if a regulated supplier does not prepare audited financial statements, then it is defined as the closest entity which does prepare audited financial statements of which the regulated supplier is a subsidiary.

23. Inclusion of avoided transmission charges from notional embedded generators as recoverable costs
IM 3.1.3(1)(f)

- The IMs allow avoided transmission charges associated with embedded generation to be included as recoverable costs (IM 3.1.3(1)(f)).
- However, it is unclear whether this clause allows the inclusion of avoided transmission charges associated with notionally embedded generators or only those associated with physically embedded generators.
- Note that Vector raised this issue with the Commission in June 2012, and the Commission responded in September 2012, stating that IM 3.1.3(1)(f) allowed for the inclusion of avoided transmission charges associated with both notionally and physically embedded generators.
- Consider that the IMs should also be amended. Suggest that IM 3.1.3(1)(f) explicitly specify that this clause relates to costs able to be avoided a result of either physical or notional connection of distributed generation.

24. Treatment of losses on disposal
IM 1.1.4

- It is unclear whether losses on disposals should be treated as (negative) other regulated income or as opex. Losses on disposal are not explicitly referred to in the IM definitions of either (Part 1).
- The ID, DPP and CPP IMs are silent on this topic in their definition of other regulated income and opex.
- However the IDD and the May 2011 s53ZD DPP information request are inconsistent on this topic.
 - The IDD requires that losses on disposal be netted off any gains to determine a value for 'gains/(losses) on sale' which is then included within other regulated income (IDD Part 1).
 - The s53ZD request in May 2011 (for the purpose of the 2012 DPP reset) required losses on disposal to be included as opex (see item #11 in the Issues Register updated 11 May 2011).



- Consider that the regulatory treatment of gains or losses on disposal should be consistent with the GAAP treatment. GAAP treats losses on sale within opex, and gains within income.
- Suggest that the IM definition of operating cost be amended to specify that losses on sale be included, and that the IDD be amended to implement this.
- Suggest that the IM definition of other regulated income be amended to specify that gains on sale be included, and that the IDD be amended to implement this.

25. The appropriate treatment of intercompany revenues in the cost allocation materiality revenue-threshold test
IM 2.1.2(2)(a)

- IM 2.1.2(2)(a) specifies a revenue threshold, for the determining which cost allocation method can be used. This involves revenues from the supply of regulated and unregulated services.
- It is not clear exactly how intercompany revenues should be treated.
- Suggest that in this context ‘revenues’ exclude intercompany revenues – ie: any revenue which is eliminated on accounting consolidation of the EDB group.
 - This was the guidance given in response to a question on the treatment of intercompany revenues in the IDD Issues Register.
- Suggest that IM 2.1.2(2)(a) be amended to reflect the above.

26. Definition of interest rate swap
IM 2.4.9(3)(a), IM 5.3.30(3)(a)

- The term ‘vanilla interest rate swap’ is used in the formulae for calculating the TCSD (IM 2.4.9(3)(a), IM 5.3.30(3)(a)). This term is not defined, and in our view it is sufficiently technical that it requires an explicit definition.
- Suggest that ‘vanilla interest rate swap’ be defined in Part 1 of the IMs, as:
 - “An agreement between a party and a counterparty whereby the party pays (or receives) a fixed interest rate and receives (or pays) a floating interest rate. The notional principal, start date of contract, duration of contract, fixed interest rate and benchmark rates are agreed to by the party and the counterparty.”

27. Definition of ‘most recently’ when referring to an EDB’s audited financial statements for ID
IM 2.4.9(2)

- The calculation of TCSD for ID and CPP requires information from the EDB’s ‘most recently published audited financial statements’.
- The CPP IMs specify that the financial statements to use are those “published most recently prior to making the CPP application” (IM 5.3.30(2)).
- However the ID IMs are less specific, as they only refer to those “most recently published” (IM 2.4.9(2)).



- Suggest that the ID IMs (ie IM 2.4.9(2)) be amended to specify that the financial statements to use should be those published most recently prior to making a disclosure of TCSD under the ID Determination.

Unintended practice

Things where the application of the IMs in practice may be different to what was envisaged

28. The definition of finance leases

IM 1.1.4, IM 3.1.3(c)

- In some cases, payments to suppliers can be included as an asset in the RAB as a finance lease while at the same time those payments are included in recoverable costs.
 - Finance leases are defined in Part 1 of the IMs as having the same meaning as under GAAP. In practice, some EDBs have recorded NIAs as finance leases.
 - In addition, an EDB can include as a recoverable cost any amount paid to Transpower associated with new investment agreements (IM 3.1.3(c)).
- This overlap seems unintentional.
- Suggest that the RAB definition of finance leases be adjusted to exclude any value associated with charges included as recoverable costs..

29. The Bloomberg NZ 'A' fair value curve, for use in TCSD, has been discontinued

IM 2.4.10(2)(a) and IM 5.3.31(2)(a)

- Some of the inputs used to determine the TCSD are derived from the 'Bloomberg New Zealand 'A' fair value curve' (IM 2.4.10(2)(a), IM 5.3.31(2)(a)).
- However this series has been discontinued by Bloomberg.
- The Commission needs to identify a suitable replacement method for determining a generic yield for an A-rated NZ bond.
- Bloomberg has not replaced this series with a similar series. Suggest that a potential alternative method is to use an A-rated US Industrials fair value curve, and convert the USD rate to a NZD rate using the standard country-to-country conversion method available in Bloomberg.

Potential improvements

Items where improved presentation and definitions could aid understanding and/or implementation

30. Related party transaction rules

IM 2.2.11(5), IDD 2.3.6(1)

- The use of the term "directly attributable costs", which occurs in both the capex (IM) and opex (IDD) rules, is ambiguous and as a result does not work in practice.
 - This term is not defined in either the IMs or the IDD.



- There are inconsistencies in how it is applied in practice because the implied definition is inconsistent between the IMs and IDD.
- The opex rules in the IDD refer to the cost allocation process as per clause 2.1.1 in the IMs, and hence apply the term 'directly attributable cost' in that context. However, the capex rules in the IMs refer to the term 'directly attributable cost' in the context of GAAP, in particular in respect of group consolidation practices. The former addresses allocation of opex between regulated and unregulated services, the latter addresses elimination of components of costs for financial reporting purposes.
- Under the opex rules, electrical contracting services are permitted an additional 17.2% to directly attributable costs. This margin is not permitted for any other directly attributable costs, including electrical contracting services which are capitalised as assets.
- Accordingly, there is confusion and inconsistency as to how
 - allocation principles
 - direct and indirect cost componentsare applied in respect of opex and capex.
- While a 17.2% margin on direct costs is permitted for contracting service opex, which allows for the recovery of indirect costs, the same is only the case if "directly attributable cost" is interpreted more widely under IM 2.2.11(5)(g) with reference to GAAP.
- In responding to a query from Unison the Commission has suggested that indirect labour costs related to the provision of contracting services from a related party should be recovered via opex, since they were unable to be recovered via capex. This appears to be inconsistent with the intent of the broader valuation IMs, and importantly introduces an inconsistency in the treatment of capex and opex between EDBs with related party contracting services, and those without. In particular, the implication of this treatment is that for companies that contract with third parties for capex and opex services, the margins on capital works will cover a proportion of the contractor's overhead costs, depreciation of plant and equipment etc, which will be capitalised into a RAB asset and recovered from consumers over time. By contrast, an EDB that provides such services in-house will expense such costs and RAB values will be lower in comparison.
- Suggest that:
 - The term "directly attributable cost" is retained in IDD clause 2.3.6 (1)(a), but that a definition is included for this term which clarifies that this includes the recovery of direct and indirect costs (eg: wages and salaries, as well as leave, training, ACC etc)
 - The term "directly attributable cost" and reference to 2.1.1 is removed from IDD 2.3.6 clause (1)(b) and replaced with "direct cost" to which a margin is



permitted for the recovery of indirect costs. A definition of “direct cost” and is required.

- The term “directly attributable cost” is removed from IM clause 2.2.11(5)(g) and replaced with “cost” as directly attributable cost is not a term relevant to GAAP.
 - EDBs be provided with an option to allocate proportions of indirect costs (e.g., depreciation and overhead costs) associated with the service delivery function (i.e., capex and maintenance activities) to capital works to enable comparability of EDBs’ performance over time by allowing capitalisation of such costs.
- There are unnecessary inconsistencies between the rules for establishing the value of related party capex (in the IMs) and related party opex (in the IDD). These inconsistencies should be removed. In particular:
 - The ‘materiality tests are inconsistent. The materiality rules for opex apply across all related party transactions (ie: opex and assets/capex), whereas the materiality rules for capex are applied only across assets. The relevant capex rule (clause (a)) refers to the “cost of all assets acquired from the related party”. However, the corresponding opex rule (clause (d)) refers to the “price paid for all services, goods, and assets acquired from the related party” and the “price paid for all related party transactions”. Suggest that the opex rule should exclude any asset related costs, and the capex rule is retained, with reference to assets and RAB. This has the effect of making opex and capex materiality independent of each other, which is appropriate so long as the materiality tests are relevant to the service (ie: opex is tested against revenue, and capex is tested against assets). This can be achieved by:
 - replacing the term “and assets” with the term “other than assets” to the opex rule in IDD 2.3.6 (1)(d)(i)
 - adding the term “other than assets” to the opex rule in IDD 2.3.6 (1)(d)(ii) after the description of the services for which the cost is determined.
 - The opex rules include a sub-clause about special contract terms (clause (e)(iv)). This sub-clause does not appear in the capex rules, and there appears to be no reason why that should be the case. We suggest this sub-clause should be included in between clauses 2.2.11(5)(c)(iii) and (iv) in the IMs, and a new definition for “special contract terms” included in Clause 1.1.4(1) consistent with the definition in the IDD.
 - The sequencing of the two sets of rules is inconsistent. This makes it more difficult for users when assessing the rules that apply to capex and opex than it needs to be. For example, the materiality tests come before the third party tests in the IMs (ie: for capex), but after in the IDD (for opex). Suggest that clauses (c) and (d) are reversed in IDD 2.3.6(1) to remove this inconsistency.
 - The IMs and IDD rules are reviewed for consistency in the implementation of an option to consolidate the related party into the EDB. At present the IMs allow for



consolidation in respect of capital works, but no similar option exists formally under IDD.

- In addition, we note that there are concerns regarding the 17.2% mark-up referred to in IDD clause 2.6.3(1)(b). The companies sourced to establish the 17.2% mark-up have a variety of operating practices in regard to business structure. For example, some of the companies have a policy of leasing plant and equipment so their direct costs attributable to projects are high and margins to cover indirect overhead costs are commensurately lower and therefore mark-ups are lower. Such factors need to be taken into account when establishing a mark-up to apply to EDBs, especially in the New Zealand market where leasing of plant and equipment is not routinely undertaken by EDBs because the market is too thin.
 - Suggest that this assumption is re-examined to confirm whether it is fit for purpose in the New Zealand context.

31. Method for adjusting CPP BBAR for the value of claw-back
IM 5.3.4(1)

- When determining a CPP price path, the value of any claw-back is deducted from BBAR (IM 5.3.4(1)). This presentation in effect describes claw-back as the amount of historical over-recovery that needs to be deducted from future revenue.
- When claw-back reflects historical under-recovery, this means the value of claw-back is a negative number. This can make it the adjustment and the values confusing.
- Suggest that IM 5.3.4(1) be amended such that BBAR is “adjusted for” the value of claw-back, and that additional specification be included as to how this adjustment is to be made.
- Suggest that IM 5.3.4(1) be amended as follows (new text in **bold**):
 - “The present value of the series of maximum allowable revenues after tax must equal the present value of the series of building blocks allowable revenues after tax **adjusted for** less any value of claw-back for the CPP regulatory period, where present values are determined in accordance with subclause (3).”

32. Revaluations information in a CPP proposal is incomplete
IM 5.4.13

- A CPP proposal is required to include values for the following, under the heading ‘revaluation information’:
 - sum of opening RAB values
 - the revaluation rate, and the CPI values used to calculate the revaluation rate.
- But this information is not all the information required to calculate total revaluations. Also required is the opening RAB values of the assets which are not revalued.
- Suggest that IM 5.4.13 be amended such that it also requires information on the opening RAB values of assets which are not revalued.



33. Specification of ID requirements considered for asset adjustment process
IM 2.2.1(4)(a)(ii)

- There is an incorrect reference to previous ID requirements in the ID IMs regarding the asset adjustment process. IM 2.2.1(4)(a)(ii) refers to the Electricity Information Disclosure Requirements 2004, when it should refer to the Electricity Information Disclosure Requirements 2008.
- The issue was noted by the Commission in its response to item #7 of the Issues Register for the s53ZD request for the 2012 DPP reset (version updated 10 May 2011). In its response, the Commission said it would consider amending it at a later date.
- While the initial RAB has already been determined by all the EDBs, amending the IMs in respect will tidy up this clause and reduce any unnecessary confusion.
- Suggest that IM 2.2.1(4)(a)(ii) be amended such that the term “Electricity Information Disclosure Requirements 2004” is replaced by the term “Electricity Information Disclosure Requirements 2008”.

34. Specification of standard physical asset lives
IM 2.2.8, Schedule A

- Schedule A of the IMs specifies standard physical asset lives for a number of assets. However, this list is far from exhaustive. There are a number of network assets that are not included on this list (eg mobile generators, power factor correction plants), and non-system assets are not included at all.
- Suggest that Schedule A be expanded to include additional common network assets and to add non-system assets.
- Prescribing more network assets standard physical asset lives will make the disaggregation into ‘standard’ and ‘no standard life’ assets under the IDD more meaningful. At the moment, the definitions of ‘standard’ and ‘no standard life’ are such that many assets typical of an EDB are included in the latter group and others that are more atypical are in the former. These definitions in the IDD could also be improved to make the disaggregation more meaningful.
- Suggest that this topic might be better considered as part of the 7-year review of the IMs.

35. The use of an engineer to determine the physical asset life for non-system assets
IM 2.2.8(1)(e)(v)

- If an asset does not have a standard asset life and there are no similar assets already in the RAB, then the IMs require that the asset life be the physical service life potential as determined by an engineer (IM 2.2.8(1)(e)(v)).
- The use of an engineer is appropriate for system assets, but for non-system assets an engineer may not be the most appropriate person to opine on the physical service life potential.
- Suggest that IM 2.2.8(1)(e)(v) be amended such that the life of non-system assets is determined by applying the life used under GAAP.



Attachment A: Restrictions

In accordance with our normal practice, PricewaterhouseCoopers specifically disclaim any responsibility to any party for any loss or damage whatsoever suffered as a result of acting in accordance with any information contained within this report.

This report has been prepared for the Electricity Networks Association to provide input into a review of the Commerce Act, Part 4 Input Methodologies. We do not assume any responsibility or liability for losses suffered by the Electricity Networks Association or any other user as a result of the circulation, publication, production or use of this report contrary to the provisions set out in this section. We specifically disclaim any obligation or liability to any party whatsoever in the event the report is supplied or applied for any purpose other than as set out above.

This report has been prepared by PricewaterhouseCoopers with care and diligence, and statements and opinions are given in good faith and in the belief on reasonable grounds that such statements and opinions are not false or misleading. No responsibility arising in any way whatsoever for errors or omissions (including responsibility to any person for negligence) is assumed by PricewaterhouseCoopers or any of its partners or employees for the preparation of this report to the extent that such errors or omissions result from PricewaterhouseCoopers' reasonable reliance on information provided by others or assumptions disclosed in this report or assumptions reasonably taken as implicit.

Neither the whole nor any part of this report nor any reference thereto may be included with or attached to any document, circular, resolution, letter or statement without the prior written consent of PricewaterhouseCoopers as to the form and context in which it may appear.

We reserve the right (but will be under no obligation) to review our analysis and if we consider it necessary, to revise our opinion in the light of any information existing at the date of this report which becomes known to us after that date. Our advice has been based solely on the facts and representations provided to us. Should facts or circumstances alter, our conclusions may change. Our advice could be affected by the issuance of future applicable legislation, regulations, consultation and regulatory decisions. We do not take responsibility for advising you of changes in our views as a result of such developments subsequent to the date of this report.