

# **Input methodologies review draft decisions**

## **Report on the IM review**

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## Associated documents

Publication date	Reference	Title
16 June 2016	978-1-869455-08-8	Input methodologies review draft decisions: Summary paper
16 June 2016	978-1-869455-09-5	Input methodologies review draft decisions: Introduction and process paper
16 June 2016	978-1-869455-10-1	Input methodologies review draft decisions: Framework for the IM review
16 June 2016	978-1-869455-11-8	Input methodologies review draft decisions: Topic paper 1 – Form of control and RAB indexation for EDBs, GPBs and Transpower
16 June 2016	978-1-869455-18-7	Input methodologies review draft decisions: Topic paper 2 – CPP requirements
16 June 2016	978-1-869455-12-5	Input methodologies review draft decisions: Topic paper 3 – The future impact of emerging technologies in the energy sector
16 June 2016	978-1-869455-13-2	Input methodologies review draft decisions: Topic paper 4 – Cost of capital issues
16 June 2016	978-1-869455-14-9	Input methodologies review draft decisions: Topic paper 5 – Airports profitability assessment
16 June 2016	978-1-869455-15-6	Input methodologies review draft decisions: Topic paper 6 – WACC percentile for airports
16 June 2016	978-1-869455-17-0	Input methodologies review draft decisions: Topic paper 7 – Related party transactions
22 June 2016	1178-2560	Draft amendments to <i>Electricity Distribution Services Input Methodologies Determination 2012</i> [2012] NZCC 26
22 June 2016	1178-2560	Draft amendments to <i>Gas Distribution Services Input Methodologies Determination 2012</i> [2012] NZCC 27
22 June 2016	1178-2560	Draft amendments to <i>Gas Transmission Services Input Methodologies Determination 2012</i> [2012] NZCC 28
22 June 2016	1178-2560	Draft amendments to <i>Commerce Act (Specified Airport Services Input Methodologies) Determination 2010</i> (Decision 709, 22 December 2010)
22 June 2016	1178-2560	Draft amendments to <i>Transpower Input Methodologies Determination 2012</i> [2012] NZCC 17

Commerce Commission  
Wellington, New Zealand

## CONTENTS

CHAPTER 1: INTRODUCTION .....	2
<b>PART 1: IM DECISIONS THAT WE PROPOSE CHANGING.....</b>	<b>12</b>
CHAPTER 2: INTRODUCTION TO PART 1 .....	12
CHAPTER 3: GENERAL PROVISIONS.....	13
CHAPTER 4: COST ALLOCATION DECISIONS WE PROPOSE CHANGING.....	20
CHAPTER 5: ASSET VALUATION DECISIONS WE PROPOSE CHANGING .....	24
CHAPTER 6: TREATMENT OF TAXATION DECISIONS WE PROPOSE CHANGING.....	51
CHAPTER 7: COST OF CAPITAL DECISIONS WE PROPOSE CHANGING.....	57
CHAPTER 8: SPECIFICATION OF PRICE DECISIONS WE PROPOSE CHANGING .....	73
CHAPTER 9: RECONSIDERATION OF THE PRICE-QUALITY PATH DECISIONS WE PROPOSE CHANGING.....	96
CHAPTER 10: IRIS DECISIONS WE PROPOSE CHANGING.....	107
<b>PART 2: IM DECISIONS THAT WE DO NOT PROPOSE CHANGING .....</b>	<b>113</b>
CHAPTER 11: INTRODUCTION TO PART 2 .....	113
CHAPTER 12: COST ALLOCATION DECISIONS WE DO NOT PROPOSE CHANGING.....	114
CHAPTER 13: ASSET VALUATION DECISIONS WE DO NOT PROPOSE CHANGING.....	119
CHAPTER 14: TREATMENT OF TAXATION DECISIONS WE DO NOT PROPOSE CHANGING.....	126
CHAPTER 15: COST OF CAPITAL DECISIONS WE DO NOT PROPOSE CHANGING.....	128
CHAPTER 16: GAS PRICING METHODOLOGIES DECISIONS WE DO NOT PROPOSE CHANGING	135
CHAPTER 17: SPECIFICATION OF PRICE DECISIONS WE DO NOT PROPOSE CHANGING .....	138
CHAPTER 18: IRIS DECISIONS WE DO NOT PROPOSE CHANGING.....	142
<b>PART 3: IM DECISIONS THAT WE DO NOT PROPOSE CHANGING, AND FOUND NO REASON TO CONSIDER CHANGING .....</b>	<b>148</b>
CHAPTER 19: INTRODUCTION TO PART 3 .....	148
CHAPTER 20: DECISIONS WE DO NOT PROPOSE CHANGING,Z AND FOUND NO REASON TO CONSIDER CHANGING .....	149
<b>ATTACHMENT A: INDEX OF EXISTING DECISIONS .....</b>	<b>179</b>

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## Chapter 1: Introduction

### Purpose of this report

1. The purpose of this report is to:
  - 1.1 present the draft results of our review of the input methodologies (IMs) for electricity lines services, gas pipeline services and specified airport services in accordance with our decision-making framework;<sup>1</sup> and
  - 1.2 summarise our draft decisions on whether to change the IMs, and explain our reasons for changing or not changing them. Our draft decisions reflect both our findings in the key topic areas for the review and the findings of our wider effectiveness review of the IMs.

### The role of this report in presenting our draft decisions on the IM review

2. This report records our draft decisions on whether to change the existing IM decisions as a result of the IM review to date.<sup>2</sup> For those existing IM decisions we are proposing to change, it explains how and why.<sup>3</sup> It also explains our reasons for the decisions we propose not to change as part of the IM review.
3. The topic papers explain our proposed solutions to the problems identified within each topic area. Most of those proposed solutions involve changes to the IMs, but some involve proposed changes to other aspects of the Part 4 regime.<sup>4</sup>
4. This report records our draft decisions on how we propose to change our existing IM decisions to give effect to those proposed solutions. For those draft decisions (ie, that are driven by a proposed solution to a problem discussed in a topic paper), we generally refer back to the reasoning in the relevant topic paper rather than repeating the reasoning in this report.

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<sup>1</sup> As noted at paragraphs 22–25, the Transpower Capex IM is outside the scope of the review, there are some specific areas within the scope of review where we have not yet reached draft decisions, and not all areas within the scope of the review are covered by this Report.

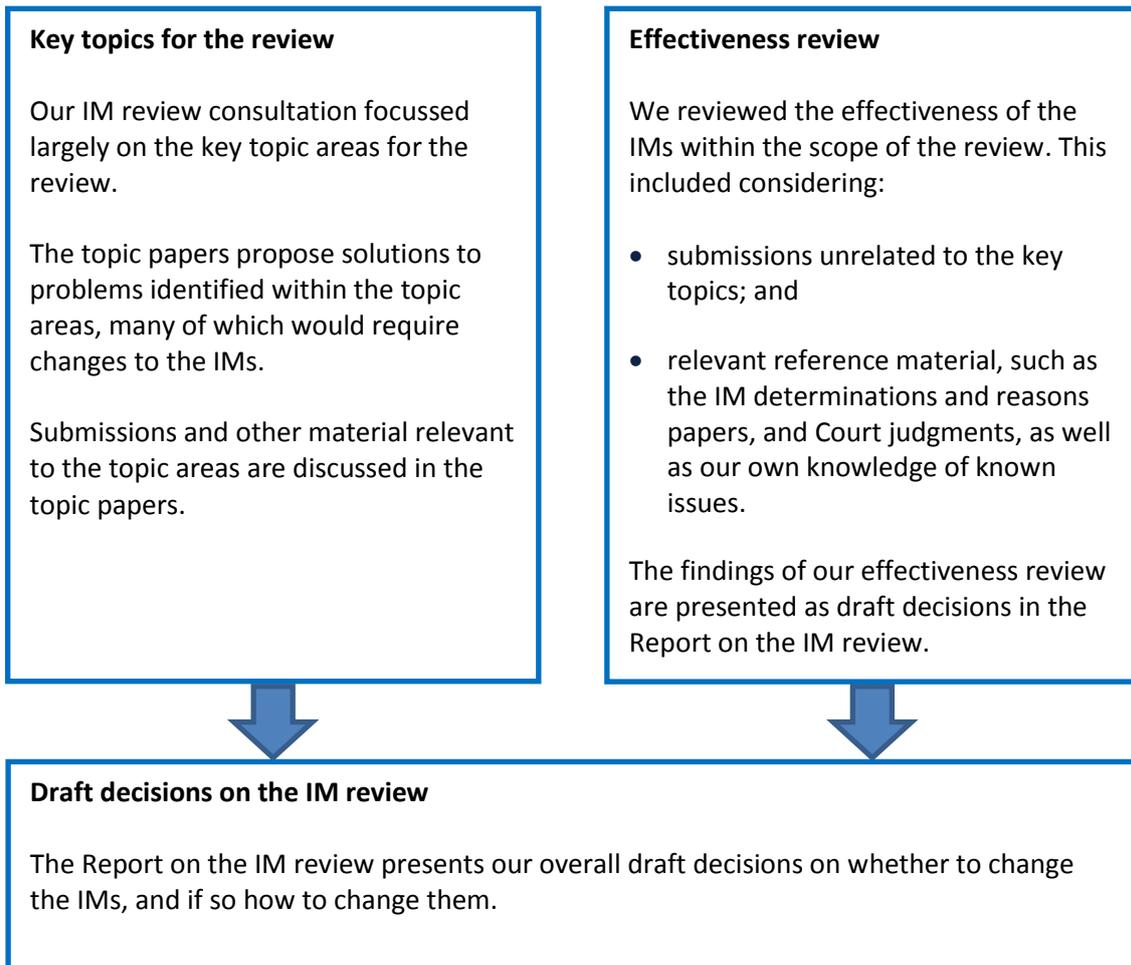
<sup>2</sup> Again, with the exceptions noted at paragraphs 22–25.

<sup>3</sup> As we discuss further below, we have derived the existing IM decisions from our previous IM reasons papers. The set of existing IM decisions are given effect to through the IM determinations.

<sup>4</sup> For example, Topic paper 5: Airports profitability assessment, proposes a number of changes to the information disclosure requirements for airports as part of the proposed solution to problems identified in that topic area.

5. As illustrated by Figure 1, this report also presents draft decisions we have reached on additional matters not covered by the topic papers.<sup>5</sup> These draft decisions record the results of our effectiveness review of the IMs to date, which was based on a review of:<sup>6</sup>
- 5.1 stakeholder submissions on the IM review; and
  - 5.2 relevant reference material, such as the IM determinations and reasons papers, and Court judgments, as well as our own knowledge of known issues.

**Figure 1: The sources of the draft decisions presented in this report**



<sup>5</sup> Most of the proposed changes in this category are minor; however, we generally provide more explanation for these draft decisions than those that are also discussed in a topic paper.

<sup>6</sup> Our effectiveness review process is described in more detail in the Introduction and Process paper. See Commerce Commission “Input methodologies review draft decisions: Introduction and process” (16 June 2016).

6. This report is framed in terms of the existing IM decisions and whether we are proposing to change them, or change how they are implemented. In many cases, the report does not necessarily go down to the level of explaining our proposals for the detailed amendments in the IM determinations that we have drafted to give effect to any proposed changes to our existing IM decisions.
7. The way we propose to give effect to the draft decisions described in this report is presented in the draft amended IM determinations, published alongside this report.<sup>7</sup> Many of the proposed drafting amendments will be self-explanatory; however, we have also released a companion log that provides links between the draft decisions in this report and the amended clauses of the IM determinations. The companion log is intended to help those making technical submissions on the draft determinations.<sup>8</sup>
8. The framework we have applied in reaching our draft decisions is set out in a separate paper, published alongside this report.<sup>9</sup> The framework paper explains that we have only proposed changing the current IMs where this appears likely to:
  - 8.1 promote the Part 4 purpose in s 52A more effectively;
  - 8.2 promote the IM purpose in s 52R more effectively (without detrimentally affecting the promotion of the s 52A purpose); or
  - 8.3 significantly reduce compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s 52A purpose).
9. As noted at paragraph 5, this report presents a number of proposed changes to the IMs that are driven by our effectiveness review, rather than as potential solutions to problems identified within the key topics. The bulk of these proposed changes are aimed at clarifying the existing rules, removing ambiguities, correcting errors, or reducing unnecessary complexity and compliance costs. We consider that, collectively, these should better promote s 52R by increasing certainty about what the rules are, as well as reducing complexity and compliance costs.

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<sup>7</sup> Today we have also published a draft amended airports ID determination, which presents drafting changes proposed as a result of the airports profitability assessment topic. See Topic paper 5: Airports profitability assessment. The draft amended airports ID determination is supported by a companion log that provides links between ID changes proposed in Topic paper 5: Airports profitability assessment and the amended clauses of the draft amended ID determination.

<sup>8</sup> The companion log is presented as an Excel spreadsheet that can be sorted by the existing IM decisions that we are proposing changes to, and by each affected clause of the relevant draft amended IM determination. This should help you track from a draft decision in this report to the resulting changes in the draft determination or vice versa.

<sup>9</sup> Commerce Commission “Input methodologies review draft decisions: Framework for the IM review” (16 June 2016).

10. The framework paper also sets out the types of questions we considered in reviewing the IMs, such as:<sup>10</sup>
- 10.1 Is the policy intent behind the IM still relevant and appropriate?
  - 10.2 Is the current IM achieving that intent?
  - 10.3 Could the current IM achieve the policy intent better?
  - 10.4 Could the current IM achieve the policy intent as effectively, but in a way that better promotes s 52R or reduces complexity or compliance costs?
  - 10.5 Do changes to other IMs require any consequential changes to the IM in question for internal consistency or effectiveness reasons?
11. The framework paper also describes key economic principles that can provide guidance as to how we might best promote the Part 4 purpose.

#### **How this report presents the draft results of the IM review**

12. This paper presents the draft results of our review against the existing IM decisions.<sup>11</sup> We consider that this is easier to follow, and more useful, than presenting the results of the review on an IM determination, clause-by-clause basis.
13. Using the IM overview tables in the 2010 IMs reasons papers as a starting point,<sup>12</sup> we have extracted the descriptions of the existing IM policy and implementation decisions. We have also included descriptions of amendments made since 2010 in order to ensure that the existing decisions listed in this report are complete and current.
14. We have assigned each of these existing IM decisions a code (eg, 'CA01' for cost allocation decision number 1) to aid submitters. We also use these codes when referring to existing IM decisions in the topic papers.

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<sup>10</sup> As noted in the framework paper, we have considered these questions where relevant in reviewing the IMs. We have not considered them in any particular order; nor have we ascribed any set weighting to each question. The questions provide practical tools, or lenses, that we have used to examine the IMs.

<sup>11</sup> As noted in the Introduction and process paper, the IM review will not be considered complete until we have taken into account submissions on our draft decisions package and our final review decision is made on all IMs within the scope of the review.

<sup>12</sup> For example, for EDB and GPB cost allocation policy and implementation decisions, refer to Commerce Commission "Input methodologies (electricity distribution and gas pipeline services): Reasons paper" (22 December 2010), pp. 57-58.

15. For some areas of the IMs, extracting the existing IM decisions was straightforward (for instance, for those chapters of the 2010 IM reasons papers that began with IM overview tables summarising decisions we made in that area). In other areas (such as those decisions that have been amended since 2010 and do not have summary tables), we have extracted the existing decisions from descriptions in the text of the relevant reasons papers.<sup>13</sup>
16. In 2012, we extended our IM decisions on cost allocation, asset valuation and the treatment of taxation to also apply to default price-quality paths (**DPPs**).<sup>14</sup> Originally, our IM decisions for these matters were only specified as applicable to customised price-quality path (**CPP**) proposals, and to information disclosure (**ID**) regulation. We extended the application of those IM decisions to apply to DPPs by taking the existing IMs as a starting point and simplifying the components where necessary.
17. In this report, we have not referred to the 2012 extensions as amendments to the original 2010 IM decisions because the existing IM decisions are generally described at a level above the detail of how the decisions apply to particular regulatory instruments.<sup>15</sup>
18. Presenting the results of the IM review in terms of the existing IM decisions allows us to illustrate where this report presents proposed changes to:
  - 18.1 the policy intent of an existing IM decision; and/or
  - 18.2 the way an existing decision is implemented.
19. This report also proposes a number of new decisions on existing IM matters.<sup>16</sup>

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<sup>13</sup> This is also the case for the CPP requirements IMs. How we have dealt with the existing IM decisions for CPP requirements IMs is explained at paragraph 25.

<sup>14</sup> See Commerce Commission “Specification and Amendment of Input Methodologies as Applicable to Default Price-Quality Paths: Reasons paper” (28 September 2012), available at: <http://www.comcom.govt.nz/dmsdocument/9506>.

<sup>15</sup> Where we have proposed a change to an existing decision that has particular relevance for a specific regulatory instrument (eg, ID, DPP, CPP or IPP), we have noted this in our explanation of the proposed change.

<sup>16</sup> For example, see proposed IM decisions GE01 and AV55 below.

20. The IM decisions are presented in the following groups:
- 20.1 general provisions (which we have coded 'GE');
  - 20.2 cost allocation (which we have coded 'CA');
  - 20.3 asset valuation (which we have coded 'AV');
  - 20.4 treatment of taxation (which we have coded 'TX');
  - 20.5 cost of capital (which we have coded 'CC');
  - 20.6 gas pricing methodologies (which we have coded 'GP');
  - 20.7 specification of price (which we have coded 'SP');
  - 20.8 reconsideration of the price-quality path (which we have coded 'RP');
  - 20.9 amalgamations (which we have coded 'AM');
  - 20.10 incremental rolling incentive scheme (**IRIS**) (which we have coded 'IR'); and
  - 20.11 other regulatory rules and processes (which we have coded 'RR').
21. We also have a group of existing IM decisions for CPP requirements (which we have coded 'CP'). As noted in paragraph 25 below, these are covered by Topic paper 2: CPP requirements, rather than this report.<sup>17</sup>

*Scope of the IM review*

22. As set out in the notice of intention, the current IM review includes all IMs as amended to date (including as a result of fast track decisions already made as part of the IM review), except the Transpower Capex IM.<sup>18</sup>

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<sup>17</sup> Although, for completeness, we have listed the existing CPP decisions in the index of all existing decisions in Attachment A of this report.

<sup>18</sup> Commerce Commission "Amended notice of intention (further amending the notice of intention dated 10 June 2015): Input methodologies review" (2 December 2015).

*Scope of our draft decisions package*

23. Our current draft decisions package presents draft decisions on all IMs within the scope of the review except the IMs covering:
- 23.1 the CPP information requirements for gas;<sup>19</sup>
  - 23.2 the related party transactions provisions;<sup>20</sup> and
  - 23.3 the Transpower IRIS.<sup>21</sup>
24. While these areas are within the scope of the IM review, as noted in this report, we have not yet reached draft decisions on them.

*Scope of this report*

25. This report covers all IMs within the scope of the review except for the CPP requirements IMs. Our draft decisions on the CPP requirements IMs are instead covered in Topic paper 2: CPP requirements, so that all information about our draft decisions regarding the CPP requirements is in one place.<sup>22</sup>

**When would our draft decisions come into effect?**

26. The draft decisions described in this paper, and reflected in the draft amended IM determinations, will not have any effect unless confirmed as our final decisions.
27. We are still aiming to reach final decisions on the IM review by December 2016. Any changes to the IMs resulting from the review will form part of the IMs when the final IM determination amendments (and final consolidated IM determinations) are published at about the same time.
28. In the case of the three areas noted above where we have not yet reached draft decisions, it is possible that once we have defined the relevant problems or reached a draft decision, we may need to extend our final decision dates on those areas beyond December 2016. We will update interested parties on our timing for draft and final decisions on these areas in our anticipated September 2016 process update.

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<sup>19</sup> As discussed in Commerce Commission “Input methodologies review draft decisions: Topic paper 2 – CPP requirements” (16 June 2016).

<sup>20</sup> As discussed in Commerce Commission “Input methodologies review draft decisions: Topic paper 7 – Related party transactions” (16 June 2016); and in this report under existing IM decision AV12.

<sup>21</sup> As discussed in Part 2 of this report as existing IM decision IR04.

<sup>22</sup> Commerce Commission “Input methodologies review draft decisions: Topic paper 2 – CPP requirements” (16 June 2016), Attachment B.

29. Our draft amended determinations released alongside this report do not contain provisions regarding the timing for the proposed amendments taking effect. This is something we will look to include once we update the draft determinations for technical consultation, which we expect to hold in October 2016.
30. However, at this stage, we would generally expect that the final amended IM determinations for all sectors would take effect:
- 30.1 for ID, at the beginning of the *next disclosure year* following publication of our final IM determination amendments, or from the *next regulatory period* following publication of our final IM determination amendments, as appropriate;
  - 30.2 for DPPs, for the next DPP reset after the date of publication of our final IM determination amendments for each sector, which varies for gas distribution businesses (**GDBs**), gas transmission businesses (**GTBs**) and electricity distribution businesses (**EDBs**);
  - 30.3 for CPPs, for CPP applications made following the date our final GDB, GTB and EDB IM determination amendments are published; and
  - 30.4 for the Transpower individual price-quality path (**IPP**), for the next IPP reset after the date of publication of our final IM determination amendments.
31. However, there may be some amendments for which other transitional arrangements might be more appropriate.<sup>23</sup>
32. We are interested in your views on the timing for amendments coming into effect, and whether transitional arrangements may be required for some provisions. In particular, we seek your views on whether certain changes to the IMs for ID should only take effect from the next regulatory period (ie, to maintain alignment between the IMs for ID and price-quality regulation for those suppliers subject to both types of regulation).

### Structure of this report

33. Following this introductory chapter, this report is split into three parts.

#### *Part 1 – IM decisions that we propose changing*

34. Part 1 lists those existing IM decisions that we propose changing (either at a policy level, or in terms of the implementation of the policy decision) as part of the IM review.

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<sup>23</sup> An example of such an exception is the proposed ‘next closest alternative provision’ (described in this report as IM decision GE01), which would take effect, for each sector, from the date of the respective final amendment determinations.

35. For each existing IM decision that we propose changing, Part 1:
- 35.1 states the existing decision as it currently stands;
  - 35.2 explains how we propose changing it; and
  - 35.3 explains why we propose changing it.
36. Part 1 also includes a number of proposed new decisions on existing IM matters.

*Part 2 – IM decisions that we do not propose changing*

37. Part 2 lists those existing IM decisions that:
- 37.1 in light of our framework, submissions on the IM review so far, and all other relevant information before us, we considered changing; but
  - 37.2 for the reasons presented in Part 2, we do not propose changing (either at a policy level, or in terms of the implementation of the policy decision) at this stage.
38. For each existing IM decision that we do not propose changing, Part 2:
- 38.1 states the existing decision; and
  - 38.2 explains why we do not propose changing it as part of the IM review.

*Part 3 – IM decisions that we do not propose changing, and found no reason to consider changing*

39. Part 3 lists those existing IM decisions that:
- 39.1 in light of our framework, submissions on the IM review so far, and all other relevant information before us, we found no reason to consider changing at this stage;<sup>24</sup> and
  - 39.2 we therefore do not propose changing (either at a policy level, or in terms of the implementation of the policy decision) at this stage.
40. We remain open, however, to receiving submissions on all existing decisions, including the existing IM decisions listed in Part 3 of this report.

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<sup>24</sup> That is not to say there have never been any issues raised in respect of the existing IM decisions listed in Part 3 of this report. Minor issues have been raised in the past that are relevant to some of the existing IM decisions listed in Part 3; but none that, when we carried out our effectiveness review, we considered were sufficiently material to lead us to consider changing the IMs.

**Invitation to make submissions**

41. We invite submissions on this report by **5pm on 28 July 2016**. We then invite cross submissions by **5pm on 11 August 2016**.
42. In respect of our draft amended determinations (including draft ID amendments for airports), we invite submissions by **5pm on 11 August 2016**.<sup>25</sup>
43. Please address submissions and cross submissions to:  
  
Keston Ruxton  
Manager, Input Methodologies Review  
Regulation Branch  
[im.review@comcom.govt.nz](mailto:im.review@comcom.govt.nz)
44. Please clearly indicate within your submission which aspects of this report it relates to.
45. The Introduction and process paper contains further details about the submissions process.<sup>26</sup> This includes:
  - 45.1 explaining that material provided outside of the indicated timeframes without an extension might not be considered in reaching our final decisions;
  - 45.2 providing guidance on requesting an extension to the submissions timeframes;
  - 45.3 noting that we prefer submissions on our draft decisions in a file format suitable for word processing, rather than the PDF file format; and
  - 45.4 providing guidance on making confidential submissions.

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<sup>25</sup> Rather than providing for cross submissions on the draft determinations, we have instead provided an extended period for primary submissions on those drafts.

<sup>26</sup> Commerce Commission "Input methodologies review draft decisions: Introduction and process paper" (16 June 2016), chapter 5.

## Part 1: IM decisions that we propose changing

### Chapter 2: Introduction to Part 1

46. This Part lists those existing IM decisions that we propose changing (either at a policy level, or in terms of the implementation of the policy decision) as part of the IM review.
47. For each existing IM decision that we propose changing, this Part:
  - 47.1 states the existing decision as it currently stands;
  - 47.2 explains how we propose changing it; and
  - 47.3 explains why we propose changing it.
48. This Part also includes a number of proposed new decisions on existing IM matters.
49. This Part is structured according to the grouping of IM decisions described at paragraph 20 in the introduction to this report.<sup>27</sup>

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<sup>27</sup> Part 1 does not have chapters on gas pricing methodologies, amalgamations or 'other regulatory rules and processes' because we do not propose any changes to those decisions.

## Chapter 3: General provisions

### New draft general provisions IM decision GE01

*We propose a new IM decision*

50. We propose making a new IM decision to allow for an alternative approach to be applied in respect of matters covered by an existing IM when that IM becomes unworkable, as follows:

<p><b>Decision GE01</b></p> <p><b>General provisions (next closest alternative)</b></p>	<p><b>Proposed new 2016 decision</b></p> <p>The next closest alternative (<b>NCA</b>) provision allows for an alternative approach to be applied when the prescriptive approach in the IMs become unworkable.</p> <p>Unworkable refers to situations where the prescriptive approach set out in the IM cannot be implemented, for example where information previously relied upon is no longer produced by a third party.</p> <p>The NCA would not cover situations where the Commission or a supplier does not agree with the result of the prescriptive IM and wishes to implement a different approach, even if that approach might promote the s 52A purpose more effectively. In particular, price paths would not be reopened within a regulatory period on the grounds of a change to an IM. Therefore, any changes to improve an IM in these circumstances would need to be made by consulting on an IM change that, if made, would take effect at the next price resetting event.</p> <p>The NCA would be a general provision applying to any of the IMs for electricity distribution services, electricity transmission services, gas pipeline services and airports. It would cover both the price-quality paths and ID, and could be applied at any time.</p> <p>The NCA provision would allow us to apply an alternative approach instead of an unworkable IM. However, the alternative approach itself would not be prescribed in the IMs. The NCA provision is intended to provide flexibility in the approach while maintaining certainty of the material effect of the IMs, by ensuring an equivalent effect, or next closest effect.</p> <p>The NCA would be formulated by us, but would usually follow a request from a supplier, highlighting a prescriptive approach that has become unworkable and proposing an alternative. In some circumstances we may also identify an approach that has become unworkable ourselves, and apply the NCA provision to resolve it.</p> <p>There are two ways the NCA could be applied. In most circumstances, we expect that the NCA would result in an equivalent outcome to the prescriptive approach. The proposed general NCA provision would then be sufficient to implement the alternative approach. In rare circumstances, applying the NCA might have a non-equivalent effect. In these cases we would also need to reopen the affected price path for the change to take effect.</p>
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	While we expect cases in which a reopener is required to be rare, we consider it important for the NCA provision to be able to be applied in place of any of the IMs in all circumstances, even if applying the alternative approach might have a non-equivalent effect on a price-quality path. We are therefore also proposing a related reconsideration provision to reopen the price-quality path in those circumstances where applying the NCA might have an impact on allowable revenue or quality standards during the regulatory period. <sup>28</sup> This reconsideration provision is proposed in the existing IM decisions RP01, RP02 and RP05 below.
<b>This decision applies to (sector):</b>	EDB/GPB/GDB/Transpower/Airports

*Reasons for the proposed new decision*

51. IM decision GE01 is a new decision we propose to address situations where, through unforeseen external circumstances, the IMs become unworkable.
52. This provision is a proposed response to a problem we identified as a result of our review of the IMs. Given the complex nature of the IMs, and their reliance on other information outside the determination, there are occasions where the IMs are affected by events outside of our control. When an IM becomes unworkable, the policy intent can be frustrated, potentially causing uncertainty and reducing the effectiveness of the IMs.
53. In our experience in applying the IMs since 2010, a number of instances of workability problems have arisen, both for us and for suppliers. Some examples are covered in the section below, including a problem we faced with the lack of relevant government bonds data required for the calculation of a weighted average cost of capital (**WACC**) estimate and a problem with calculating the Term Credit Spread Differential (**TCSD**) when Bloomberg stopped publishing the New Zealand 'A' fair value curve.

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<sup>28</sup> Price is defined in s 52C as able to be specified in the form of numbers or formulas. Therefore, a non-equivalent effect on a price path could potentially arise from either a change in price, or a change in the formula for determining price.

54. Ordinarily we would resolve any workability problems by making an amendment to the IMs. However, there are a number of situations where this might not be appropriate or feasible. These include situations where:
- 54.1 there is a need for an urgent material change, such as when the relevant approach needs to be applied without there being time to undertake the s 52X/52V process;
  - 54.2 a change to the IMs to resolve a workability problem would not otherwise take effect until the next regulatory period, which may be the case if an alternative approach affects a price-quality path;<sup>29</sup>
  - 54.3 the alternative approach would only apply to a small sub-set of regulated businesses, which does not warrant a change to the IMs; or
  - 54.4 the workability problem may be temporary, so the alternative approach may also be time-bound, and over time the existing IM might become functional again.
55. The proposed NCA provision is intended to provide for greater flexibility, so we can address all workability problems in a timely manner, even when a s 52X amendment is not appropriate or feasible. This will allow us to continue to apply the policy intent as closely as possible. We consider this appropriate for two key reasons:
- 55.1 We have been given broad discretion to set regulatory processes and rules for the Part 4 regime, including the circumstances in which price-quality paths may be reconsidered within a regulatory period. We need to be able to apply the policy intent of the IMs in a timely and cost-effective way even where a prescriptive approach set out in the IMs becomes unworkable.
  - 55.2 We are mindful that the IMs must promote certainty about the rules that apply (s 52R), and that suppliers should be reasonably able to estimate the material effects of the IM on the supplier (s 52T(2)(a)). The NCA would promote certainty about the material effects of the IM, even if the prescriptive approach set out in the IM becomes unworkable. Without the NCA, the consequence of an IM being unworkable could become entirely unpredictable.

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<sup>29</sup> Under s 53ZB we are limited in the circumstances where we can reopen a DPP or CPP within a regulatory period on the grounds of a change in an input methodology.

*When and how the proposed NCA provision would apply*

56. The NCA would only apply in the limited circumstances where an IM became unworkable, and there was a need for an urgent material change (such as when the relevant approach had to be applied without there being time to undertake the s 52X/52V process) or if any change to the IM could not otherwise take effect until the next regulatory period. For other problems, we would consider making a non-material IM amendment under s 52X.
57. There are two ways the NCA could be applied. In the first instance we would aim to apply an alternative that achieves an equivalent effect to that which would have occurred had the approach prescribed in the IMs been possible. However, in some circumstances it might not be possible to achieve an equivalent effect, or to demonstrate that an equivalent effect has been achieved. In these cases we would apply an alternative approach with the next closest effect to the prescribed approach.

Example where applying an IM became unworkable for us: Lack of relevant government bonds data for publishing a WACC estimate

58. A recent example where the IMs became unworkable was in the 30 June 2015 WACC rate for CPP proposals made by Maui Development Limited (**MDL**).<sup>30</sup>
59. Under the IMs we were required to use NZ government bonds data as part of our process to estimate the debt premiums for the purposes of calculating a vanilla WACC.<sup>31</sup> However, no government bonds that were issued between June 2015 and November 2017 fitted the criteria in the IMs.
60. We were therefore unable to estimate the 3 and 4 year debt premiums using the prescriptive approach set out in the IMs.
61. In order to calculate the WACC determination, we used a 12 month Treasury bill in place of a NZ government bond. The NCA provision would have expressly allowed us to use this alternative approach.

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<sup>30</sup> *Cost of capital determination for customised price-quality path proposals made by Maui Development Limited for gas transmission services* [2015] NZCC 17.

<sup>31</sup> See *Gas Transmission Services Input Methodologies Determination 2012* [2012] NZCC 28, clause 4.4.4, for details of the methodology for estimating the debt premium.

Example where applying an IM became unworkable for a regulated supplier: Bloomberg discontinuing publication of a key input into the TCSD calculation

62. As noted above, we expect that in most circumstances it will be regulated suppliers that will face difficulties when a particular approach in an IM becomes unworkable. One example of this was the calculation of the TCSD by Transpower.<sup>32</sup>
63. The TCSD methodology required the use of the Bloomberg New Zealand ‘A’ fair value curve.<sup>33</sup> This methodology became unworkable when Bloomberg stopped publishing this data series.
64. To fix this issue we made an amendment to the Transpower IM Determination by substituting an equivalent reference set for the defunct Bloomberg reference set.<sup>34</sup> The NCA would have allowed us to provide an alternative solution to the unworkable methodology in a more timely, and potentially less complicated, way.
65. In both this example, and the NZ government bond example, the change was made without the need for a reconsideration of the price path. This is why we anticipate that the price path reconsideration provision associated with the NCA would be rarely used.

Example where compliance with a methodology may become unworkable in the future: Reliance on codes set by other regulatory agencies

66. In addition to the above examples, we have considered potential situations where the NCA might be required. For example, in several places the IMs rely on the Vector Pipeline Operating Code and Maui Pipeline Operating Code. If these codes were changed, parts of the IMs may become unworkable. An NCA could be used to provide an alternative approach in these situations rather than an IM amendment being necessary.

*Details of the proposed new decision*

67. We propose including a new provision in the ‘general provisions’ section of the IMs to implement the NCA. The provision could be applied to any other clause in the IMs and would allow the application of:
- 67.1 the prescriptive method set out in the relevant IM; or
- 67.2 if the IM is rendered unworkable, the NCA approach (ie, a non-prescriptive alternative approach intended to achieve an equivalent effect, or the next closest effect, to applying the prescriptive method).

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<sup>32</sup> For details on the TCSD and what it is used for see Commerce Commission “Input methodologies (Transpower) reasons paper” (December 2010).

<sup>33</sup> See *Transpower Input Methodologies Determination 2012* [2012] NZCC 17, clause 2.4.10, for details of the TCSD methodology.

<sup>34</sup> *Transpower Input Methodologies Amendment Determination 2015 (No.2)* [2015] NZCC 27.

68. The NCA provision would allow us to apply an alternative approach instead of an unworkable IM. However, the alternative approach itself would not be prescribed in the IMs. It would not be feasible to develop alternative approaches for all prescriptive current methodologies where workability problems may arise. The alternative approach would be developed at the time the prescriptive IM becomes unworkable, and published outside the IMs.
69. No reconsideration of any affected price-quality path would need to occur where the alternative approach affects:
- 69.1 an existing price-quality path where the prescriptive method becomes unworkable after having already been applied in setting that path; or
  - 69.2 an existing price-quality path where the IM becomes unworkable, and an NCA can be developed that has an equivalent effect to the expected application of the current prescriptive method if it were still workable.
70. We are also proposing a related reconsideration provision to allow us to reopen a price-quality path where we consider the NCA has a non-equivalent effect on a price-quality path.<sup>35</sup> Details of this reconsideration provision can be found in the discussion for IM decisions RP01, RP02 and RP05.
71. As outlined above, we propose that a supplier may request that we apply the NCA, or we may initiate the application of the NCA ourselves. If a supplier initiates the process, it would be required to provide us with:
- 71.1 identification of the unworkable IM, and an explanation of why it considers the IM to be unworkable;
  - 71.2 a description of a proposed NCA approach;
  - 71.3 a description of whether the NCA approach is likely to have an equivalent or non-equivalent effect to that of the unworkable IM; and
  - 71.4 certification of the information provided if certification is specified in the relevant s 52P determination (ID, DPP, CPP or IPP).

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<sup>35</sup> Price is defined in s 52C as able to be specified in the form of numbers or formulas. Therefore, a non-equivalent effect on a price path could potentially arise from either a change in price, or a change in the formula for determining price. We expect that the situations where a reconsideration of a price-quality path is necessary would be rare.

72. We would then decide whether a clause or sub-clause of an IM is not workable because an IM cannot be reasonably applied as intended and, if it cannot, we would:
- 72.1 describe the NCA approach that would apply instead of the unworkable IM;
  - 72.2 decide whether the NCA approach is likely to have an equivalent or non-equivalent effect to the unworkable IM, and whether a change is required to a s 52P determination to give effect to the NCA (for example a change to the price path);
  - 72.3 undertake any consultation we consider appropriate; and
  - 72.4 publish our decision, including a description of the alternative approach.

## Chapter 4: Cost allocation decisions we propose changing

### Existing cost allocation IM decision CA03

<b>Decision CA03</b> <b>Process for deciding allocation approach</b>	<b>Original 2010 decision</b> <p>The IM specifies the process for deciding which of the three approaches suppliers must use to allocate shared costs in different circumstances.</p> <p>See Appendix B, sections B2 and B3, of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *How we propose changing this decision*

73. Our draft decision is to make a change to IM decision CA03. As discussed in Topic paper 3: The future impact of emerging technologies in the energy sector, we propose lowering the Revenue Materiality Threshold from the current 20% to an amended 10%.

#### *We also propose implementation changes for this decision*

74. We have also identified two implementation issues with IM decision CA03:
- 74.1 distributions to consumer owners are not included in the list of items excluded from operating costs; and
  - 74.2 intercompany revenues within a company group should not be included in revenue for the purpose of the revenue materiality threshold.
75. We therefore propose making the following implementation changes to this IM decision to:
- 75.1 strengthen the wording of the relevant IM determinations to ensure that distributions to consumers (eg, payments of cash, distributions of product or issuing of shares) are not treated as operating costs; and
  - 75.2 amend the Cost Allocation IMs to state that intercompany revenue should not be included in revenue for the purposes of assessing the revenue materiality threshold.

#### *Why we propose making these implementation changes*

##### Payments to consumers

76. The IMs currently have a list of items which are excluded from operating costs. However, distributions to consumer owners are not included on this list. This creates some uncertainty about how these distributions are being treated for the purposes of the IMs.

77. There are no grounds to treat these transfers as an operating cost. If EDBs are treating distributions to consumer owners in this way, then they may be using the avoidable cost allocation methodology (**ACAM**) approach for cost allocation accounting inappropriately. This is undesirable from a regulatory perspective, as ACAM allows a greater proportion of shared costs to be recovered from consumers of regulated services.
78. We are currently unable to determine how EDBs are electing to account for these distributions and this is affecting the comparability of the ID data.
79. We consider that changing the IMs to clarify that EDBs may not treat distributions to consumer owners as operating costs will better give effect to the intention behind the affected cost allocation provisions. This proposed change should remove a potential source of uncertainty from the IMs.

#### Treatment of intragroup revenue

80. Electricity Networks Association (**ENA**) and PricewaterhouseCoopers (**PwC**) submitted in February 2014 that we should update the IMs to clarify that intercompany revenues within a company group should not be included in revenue for the purpose of the revenue materiality threshold for cost allocation.<sup>36</sup>
81. This change would align with our guidance for ID that companies should exclude intercompany revenue within a group.<sup>37</sup>
82. It is logical to exclude intragroup revenues as it may be possible for companies to use these revenues to manipulate their reported revenues for regulatory purposes in order to fall under the revenue materiality threshold.
83. We consider that this change would remove a potential source of uncertainty from the IMs.

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<sup>36</sup> ENA and PwC "Review of input methodologies" (14 February 2014), para 25.

<sup>37</sup> Commerce Commission "Section 53ZD Notice Information Request for EDBs' 2010-2015 EDB DPP Starting Prices: Commerce Commission Responses to Request for Technical Guidance/Clarification" (10 May 2011). Available at: <http://www.comcom.govt.nz/dmsdocument/505>.

### Existing cost allocation IM decision CA04

<b>Decision CA04</b> <b>ABAA causal relationship approach and proxy allocators</b>	<b>Original 2010 decision</b> <p>Under the accounting-based allocation approach (<b>ABAA</b>), where possible, cost and asset allocators used to allocate costs to regulated activities must be based on current 'causal relationships'.</p> <p>Where this is not possible, proxy allocators must be used instead.</p> <p>See section 3.3 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *We propose an implementation change for this decision*

84. As discussed in Topic paper 3: The future impact of emerging technologies in the energy sector, our draft decision is to make an implementation change to IM decision CA04 to improve the way the existing decision is implemented. Our draft decision is to strengthen the wording of the relevant IM determinations to ensure that regulated suppliers that use proxy allocators justify:

84.1 why they have used a proxy rather than a causal allocator; and

84.2 why they have used the particular proxy allocator(s) they have used rather than others.

#### *Why we propose making this change*

85. Our reasons for this proposed change are explained in Topic paper 3: The future impact of emerging technologies in the energy sector.

## Existing cost allocation IM decision CA12

<b>Decision CA12</b> <b>Causal relationship approach and proxy allocators – Airports</b>	<b>Original 2010 decision</b> Where possible, cost and asset allocators used to allocate costs to regulated activities must be based on current ‘causal relationships’.  Where this is not possible, proxy allocators must be used instead.  See section 3.3; Appendix B of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

### *We propose an implementation change for this decision*

86. In respect of IM decision CA12, our draft decision is to make a change to the Airports IMs to improve the way the existing decision is implemented, consistent with our decision on IM decision CA04 above for EDBs and gas pipeline businesses (**GPBs**).
87. We propose strengthening the wording of the Airports IMs to ensure that regulated suppliers that use proxy allocators justify:
- 87.1 why they have used a proxy rather than a causal allocator; and
  - 87.2 why they have used the particular proxy allocator(s) they have used rather than others.

### *Why we propose making this change*

88. Our reasons for proposing changes to this decision are the same as for the proposed changes to IM decision CA04 and would ensure consistency between the EDB/GPB IMs and the Airports IMs.

## Chapter 5: Asset valuation decisions we propose changing

### Existing asset valuation IM decision AV05

<b>Decision AV05</b> <b>Finance leases and intangible assets</b>	<b>Original 2010 decision</b> <p>EDBs and GPBs may include in their regulatory asset base (<b>RAB</b>) values finance leases and intangible assets provided that they are identifiable non-monetary assets that are not goodwill, consistent with the meanings under generally accepted accounting principles (<b>GAAP</b>).</p> <p>EDBs and GPBs must establish the value of permitted intangible assets added to the RAB value after the last day of the disclosure year 2009 using the cost model for recognition under GAAP.</p> <p>See section E3, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *We propose an implementation change for this decision*

89. In respect of IM decision AV05, our draft decision is to make a change to the IMs to improve the way the existing decision is implemented.
90. We propose amending the application of the term ‘finance leases’ for the purposes of the RAB rules in the IMs to have the effect of excluding from the RAB any value associated with amounts treated under the IMs as finance lease recoverable costs.

#### *Why we propose making this change*

91. In some cases, finance leases can be included as an asset in the RAB, while at the same time the associated lease payments are included in recoverable costs.
92. ENA and PwC raised this issue in a February 2014 submission and noted that it appears to be an unintentional consequence.<sup>38</sup> They suggested that the RAB definition of finance leases be adjusted to exclude any value associated with charges included as recoverable costs.
93. Having reviewed the IM, we agree that the possible double recognition of the lease amounts under the IM is unintentional. We propose amending the EDB, GDB and GTB IMs to clarify that no double recognition of the lease payments is permitted.
94. As noted under IM decision AV25, we also propose making the same change for Transpower.

<sup>38</sup> ENA and PwC “Review of Input Methodologies” (14 February 2014), para 28.

95. As this issue only arises under price-quality paths, no comparable changes to the Airports IMs (ie, IM decision AV44) would be required.

#### Existing asset valuation IM decision AV09

<b>Decision AV09</b> <b>Capital contributions</b>	<b>Original 2010 decision</b> EDBs and GPBs must recognise capital contributions by adding the asset in question to the RAB value at cost (measured in accordance with GAAP), reduced by the amount of the capital contribution received (where the capital contribution does not reduce the cost of the asset under GAAP).  See section E7, Appendix E of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *We propose implementation changes for this decision*

96. In respect of IM decision AV09, our draft decision is to change the IMs to improve the way the existing decision is implemented.
97. We propose making the following implementation changes for this IM decision:
- 97.1 Expand the definition of ‘capital contributions’ to include money received in respect of asset acquisitions.
- 97.2 Amend the IMs so that the calculation of the financing cost that can be capitalised in the RAB on a commissioned asset is based on a value of works under construction that is net of capital contributions at any stage. This would include any situation where a capital contribution is received before money is spent on the works.
98. These changes would apply to EDBs, GDBs and GTBs. We similarly propose amending IM decision AV48 for airports.

*Why we propose making these changes*

99. We consider that the policy intent of IM decision AV09 remains appropriate. However, the current IM could achieve the policy intent more effectively.
100. We considered whether the scope and definition of capital contributions may be too narrow in the IMs. In particular, we considered whether there is a gap in how the IMs achieve the policy intent in situations where:
  - 100.1 capital contributions are made towards an asset that already exists before being commissioned (eg, the asset is acquired, rather than constructed);
  - 100.2 capital contributions for an asset are received in advance of the asset being constructed or commissioned; or
  - 100.3 capital contributions are spread over the commissioning of assets over time.
101. The current definition of capital contributions appears to be broad enough to capture any type of consideration received for the purposes of asset construction or enhancement. However, capital contributions for an asset acquisition may fall outside of this definition, and so could potentially avoid being deducted from the RAB when the acquired asset is commissioned.
102. Expanding the definition of capital contributions to include acquisitions would improve the current IM so that it achieves the policy intent more consistently, regardless of whether an asset is constructed or acquired.
103. The IMs currently allow a financing cost on works under construction to be capitalised to the RAB when a constructed asset is commissioned (ie, when it enters the RAB). However, there are no rules in the IMs to deal with the impact of capital contributions on the calculation of those financing costs. Consistent with this IM decision, we propose that when calculating the financing costs on works under construction, the value of the works under construction would be reduced by the capital contributions received.
104. The IMs allow interest to be capitalised under GAAP from the point at which a project meets the definition of 'works under construction' up until the project becomes a commissioned asset. This timeframe would not change under our proposed change to the IM, as the receipt of a capital contribution in a case where a project has not otherwise met the 'works under construction' test would arguably signal a forecast construction and therefore start the clock ticking on a 'works under construction'.
105. The definition of 'works under construction' in the IMs is very broad and is likely to encompass almost any situation where a third party could make a capital contribution towards an asset that has not yet been commissioned, including when assets are forecast for construction.

## Existing asset valuation IM decision AV12

<p><b>Decision AV12</b>  <b>Assets purchased from regulated supplier</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Where an EDB or GPB purchases an asset from another regulated supplier it must add the asset to its RAB value at the asset's equivalent value in the RAB of the seller.</p> <p>Where an EDB or GPB purchases an asset from a related party (that does not supply services that are regulated under Part 4), it must add the asset to its RAB at depreciated historic cost where documentation is available to support this.</p> <p>Where sufficient records do not exist to establish depreciated historic cost, it must use the asset's market value as verified by an independent valuer. For this purpose a related party includes both:</p> <ul style="list-style-type: none"> <li>• business units of the same EDB and GPB that supply services other than electricity transmission services; and</li> <li>• a party that under GAAP is considered a related party (including any party that has conducted business either directly or indirectly with the supplier in the current financial year).</li> </ul> <p>See section E8, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2012 amendment to this decision</b></p> <p>In 2012, we amended the treatment of asset valuations in related party transactions in the ID and CPP IMs applicable to EDBs, GDBs and GTBs by:</p> <ul style="list-style-type: none"> <li>• modifying the treatment of asset acquisitions by EDBs, GDBs and GTBs from related parties.</li> <li>• amending the treatment of related party asset acquisitions to provide additional methods for suppliers to establish that these transactions reflect 'arm's-length' equivalent values. These amendments provided greater flexibility for suppliers to address individual circumstances, while continuing to ensure that the arm's-length nature of the transactions is supported by objective criteria.</li> </ul> <p><a href="#">Electricity and Gas Input Methodologies Determination Amendments (No.1) 2012: Reasons Paper (29 June 2012)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

*We propose an implementation change for this decision*

106. In respect of IM decision AV12, our draft decision is to make a change to the IMs to correct a drafting error. However, as discussed in paragraph 111, we have still to reach draft decisions on other aspects of the related party transactions requirements.
107. At this stage, the specific clarification we propose is to change the EDB, GDB and GTB IM Determinations to replace all references to 'related company' in the IM determinations with the term 'related party'.

*Why we propose making this change*

108. The use of the term 'related company' instead of 'related party' in some parts of the EDB, GDB and GTB IM Determinations appears to be an error. References to the term 'related company' were not intended to encompass a narrower term than the defined term 'related party'.
109. This issue was raised by ENA and PwC in a submission to us in February 2014.<sup>39</sup>

*Issues we have considered where no change is proposed*

110. As discussed in Topic paper 7: Related party transactions, we have identified other issues with the implementation of the related parties IM provisions.
111. As discussed in that paper, we do not propose making any IM changes in response to those issues at this stage; instead we plan to further explore whether the identified issues amount to a broader problem with the related party transactions regime and consider what the best solution to any such problem might be. We propose doing this within the current IM review, and anticipate updating stakeholders on the timing for our further draft and final decisions in respect of the related party transactions IMs in September 2016.

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<sup>39</sup> ENA and PwC "Review of input methodologies" (14 February 2014), para 14.

### Existing asset valuation IM decision AV13

<b>Decision AV13</b> <b>Financing costs on works under construction – excludes exempt EDBs</b>  <b>(original 2010 decision amended)</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs subject to default/customised price-quality regulation must capitalise financing costs on works under construction in accordance with GAAP, at a rate no greater than the 75<sup>th</sup> percentile for the regulatory post-tax WACC determined under the cost of capital IM, for the purpose of ID and CPPs.</p> <p>See section E5, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>Our final decision was to use the 67<sup>th</sup> percentile estimate of post-tax WACC as a limit when determining the value of commissioned assets under particular provisions of the IMs. This change took effect as of the commencement dates specified in the amendment determination; it did not require subsequent changes to the ID requirements before suppliers were required to apply it.</p> <p><a href="#">Amendments to the WACC percentile range for information disclosure regulation for electricity lines services and gas pipeline services: Reasons Paper (12 December 2014)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *How we propose changing this decision*

112. In respect of IM decision AV13, we propose amending the IM decision to require non-exempt EDBs, GDBs and GTBs to use their GAAP cost of financing, capped at its New Zealand dollar weighted average cost of borrowing, when calculating the cost of financing for assets under construction. This is consistent with the change we are proposing to IM decision AV33 for Transpower.
113. The cost of financing would apply for the period from when the asset becomes a works under construction until its commissioning date.

#### *Why we propose making this change*

114. Our reasons for proposing this change are the same as those for our proposed change to IM decision AV33 for Transpower.

### Existing asset valuation IM decision AV14

<b>Decision AV14</b> <b>Financing costs on works under construction – exempt EDBs</b>	<b>Original 2010 decision</b> <p>Exempt EDBs must capitalise financing costs on works under construction in accordance with GAAP, at a rate no greater than their own estimate of their cost of capital.</p> <p>See section E5, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	Exempt EDBs

#### *How we propose changing this decision*

115. In respect of IM decision AV14, we propose amending the IM decision to require exempt EDBs to use their GAAP cost of financing, capped at its New Zealand dollar weighted average cost of borrowing, when calculating the cost of financing for assets under construction. The cost of financing would apply for the period from when the asset becomes a works under construction until its commissioning date.

#### *Why we propose making this change*

116. We propose changing this approach to maintain consistent disclosures for exempt EDBs and non-exempt EDBs (IM decision AV13).

### Existing asset valuation IM decision AV17

<b>Decision AV17</b> <b>Standard asset lives apply – with listed exceptions</b>	<b>Original 2010 decision</b> <p>EDBs and GPBs must use the standard asset lives in Schedule A of the IM Determination, with the following exceptions:</p> <ul style="list-style-type: none"> <li>• EDBs and GPBs must depreciate fixed life easements over the expected term of the easement;</li> <li>• For dedicated assets, EDBs and GPBs may assign an asset life equal to the life of the supporting customer contract;</li> <li>• EDBs and GPBs may extend asset lives beyond those provided in the list of standard physical asset lives, and set asset lives for refurbished assets, without an independent engineer's report;</li> <li>• EDBs and GPBs may reduce an asset life, provided the reduced asset life is supported to an independent engineer's report;</li> <li>• EDBs and GDBs must determine when to commence depreciating network spares consistent with GAAP;</li> <li>• Where EDBs and GPBs add a found asset to the RAB, and where an EDB's or GPB's RAB already contains a similar asset, the asset life of the found asset should be the asset life applying to the similar asset.</li> </ul>
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	<p>For asset commissioned in the future that are not covered by the list of standard physical asset lives, regulated suppliers must establish physical asset lives as follows:</p> <ul style="list-style-type: none"> <li>• where an asset of the same type is already in the RAB, using the same asset life as assigned to the existing asset; or</li> <li>• otherwise, by setting an asset life for the asset supported by an independent engineer's report.</li> </ul> <p>For assets in the initial RAB value, the physical asset life will be the asset's existing remaining life as at the balance date for each EDB's or GPB's 2009 disclosures.</p> <p>Where an asset comprises a number of components with differing lives (a 'composite asset'), EDBs and GPBs must calculate the total asset life for the composite asset as a weighted average of the lives of those components.</p> <p>For the purpose of CPP proposals, no system fixed assets should be forecast to be written off during a regulatory period. All such assets in service at the start of a CPP regulatory period are deemed to have a physical asset life equal to the duration of the CPP period.</p> <p>See section E10, Appendix E of 2010 EDP-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *How we propose changing this decision*

117. As discussed in Topic paper 3: The future impact of emerging technologies in the energy sector, our draft decision is to make a policy change to IM decision AV17 as it applies to EDBs, but not to GDBs or GTBs.
118. The change would allow EDBs the option to adjust asset lives by a moderate amount in certain circumstances. This draft decision would give effect to our proposed solution to the problem related to partial capital recovery, which is explained, along with the reasons for our proposed solution, in Topic paper 3: The future impact of emerging technologies in the energy sector. That paper also explains the reasons for our draft decision not to propose the same change to this existing decision as it applies to GPBs.
119. To implement this policy change, we propose that an EDB subject to a DPP would, at the time a DPP is reset, be able to propose a factor by which to adjust the weighted average remaining asset life for its existing assets. An EDB that proposes a factor would have to justify why it requires this adjustment and may not apply for a factor lower than 0.85. We would then review this proposal, giving consideration to its impact on pricing.

120. EDBs would be required to adjust their individual asset lives used for ID to ensure that in the first year of the new regulatory period, the implied weighted average asset life for the purposes of ID is consistent with their new weighted average remaining asset life for the purposes of the DPP. Assets commissioned after this date would have asset lives which are in line with similar assets already in the RAB.
121. Because asset lives for forecast commissioned assets are already only an approximation (ie, 45 years irrespective of the type of asset),<sup>40</sup> we do not propose that the change for new assets would affect the way the DPP is reset. However, any approved reduction in asset lives would affect the depreciation amounts of both existing and commissioned assets reported under ID during the DPP regulatory period, and would therefore affect the RAB at the beginning of the following DPP period.
122. In subsequent regulatory periods, the weighted average asset life for existing assets would be calculated using the RAB and depreciation from the ID in the relevant base year. No further adjustment factor would be applied.
123. Because of the added complication that would occur if we allowed EDBs to make multiple adjustments, we are proposing to only allow EDBs to make one adjustment.

*We also propose implementation changes for this decision*

124. We also propose making the following changes to IM decision AV17 to improve the way the existing decision is implemented for EDBs, GDBs and GTBs:
- 124.1 amend the IMs so that the asset life of non-system assets is determined by applying the asset life used under GAAP;
- 124.2 amend the IMs to make it clear that asset lives are not reset on transfers of assets;
- 124.3 amend the IMs so the value of an asset is adjusted for depreciation and revaluation applying in the year of transfer; and
- 124.4 amend the IMs to remove a requirement for suppliers to spread depreciation for 'end of life' assets over the regulatory period.

*Why we propose making these implementation changes*

Allowing the use of GAAP for non-system assets

125. We consider that this proposed change would reduce complexity and compliance costs, without reducing the effectiveness of the IM in achieving its policy intent.

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<sup>40</sup> Commerce Commission "Specification and Amendment of Input Methodologies as Applicable to Default Price-Quality Paths: Reasons paper" (28 September 2012), para 55.2.

126. Currently, if an asset does not have a standard asset life and there are no similar assets already in the RAB, the EDB, GDB and GTB IMs require that the asset life be the physical service life potential as determined by an engineer.
127. ENA and PwC submitted that, although the use of an engineer is appropriate for system assets, an engineer might not be the most appropriate person to opine on the physical service life potential of non-system assets (eg, office equipment or motor vehicles).<sup>41</sup>
128. We agree with this point and consider that there is no alternative to using GAAP for non-system assets that would justify the additional compliance costs.
129. If the proposed amendment did have a consequential impact on the depreciation of EDB's non-system assets, the potential influence on the price path would be minimal, as non-system assets only make up around 3% of total assets in the RAB for EDBs.

#### Clarifying that asset lives are not reset upon transfer

130. This change clarifies the application of the existing IM decision. The intent of the IMs is that asset lives should not change as a result of a transfer. However, one possible interpretation of the IMs suggests that the asset lives are treated as being commissioned at the date of acquisition. This would mean inappropriately treating aged assets as if they were brand new when they are acquired. Further, maintaining existing asset lives and allowing the adoption of asset lives of similar assets is consistent with the original policy intent.

#### Ensuring accurate accounting of depreciation and revaluation for transferred assets

131. The intent of the IMs is that regulated suppliers should not receive more than the total value of an asset in depreciation. However, the current IMs allow for asset lives to be transferred to the purchaser at their opening RAB value on the vendor's balance sheet. In addition, they are treated by the vendor as being commissioned assets in that year. As such, their value is not depreciated or revalued in the year they are transferred. However, the vendor is still entitled to earn depreciation from these assets (ie, there is no revaluation of the asset).
132. We propose dealing with this by having an asset transfer at what would be the vendor's closing RAB value.

#### Removing the requirement to spread depreciation for 'end of life' assets over the regulatory period

133. Currently, the EDB, GDB and GTB CPP IMs require suppliers to spread depreciation for 'end of life' assets over the CPP regulatory period.<sup>42</sup>

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<sup>41</sup> ENA and PwC "Review of input methodologies" (14 February 2014), para 35.

<sup>42</sup> This requirement was removed from Transpower's IPP in August 2014.

134. The requirement is difficult for suppliers to implement due to the complexity of accounting for a change in the depreciation rate for assets at the end of their lives, and this calculation is performed purely to satisfy this requirement.
135. The rationale for proposing to delete this requirement is for the same reasons articulated in the August 2014 Transpower IPP Reasons Paper, and it also would mean there is consistency across the sectors.<sup>43</sup>

*Issues we have considered where no change is proposed*

136. We have considered whether we should expand the list of standard asset lives to include additional assets (both network and non-network) that regulated suppliers often hold.
137. ENA and PwC<sup>44</sup> and MDL<sup>45</sup> have argued that the list of assets with standard asset lives (ie, those included in Schedule A of each relevant IM determination) is missing a number of important assets. They propose that we expand the list of standard asset lives to include additional assets (both network and non-network) that regulated suppliers commonly hold.

*Why we do not propose changing this decision in response to this issue*

138. The asset lives lists in Schedule A of each of the EDB, GDB and GTB IM Determinations were largely based on existing lists prepared prior to the IMs being first set (ie, 2004 for EDBs and 2007 for GPBs).<sup>46</sup> These lists of assets might be somewhat out-of-date as technology has moved on since they were produced.
139. However, the list of standard assets was never intended to be comprehensive. The IMs provide methods for dealing with assets that are not on the list. These methods attempt to minimise compliance costs by allowing EDBs to use the asset lives of similar assets.
140. Nevertheless, we are not best-placed to judge what type of asset lives should be on the list. Therefore, we invite submitters to propose new standard asset lives along with evidence supporting these proposals. We will assess these proposed asset lives and consider introducing the appropriate ones into the relevant Schedule A. It may be most efficient for suppliers to provide a consolidated submission that reflects the combined views of most of the suppliers in each of the relevant sectors, if possible, rather than individual submissions from suppliers.

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<sup>43</sup> Commerce Commission "Setting Transpower's individual price-quality path for 2015-2020" (29 August 2014).

<sup>44</sup> ENA and PwC "Review of input methodologies" (14 February 2014), para 34.

<sup>45</sup> MDL, Untitled submission on problem definition paper (21 August 2015), pp. 13-14.

<sup>46</sup> Commerce Commission "Input methodologies (electricity distribution and gas pipeline services): Reasons paper" (22 December 2010), paras E10.12-E10.23.

## Existing asset valuation IM decision AV25

<b>Decision AV25</b> <b>Finance leases and intangible assets – Transpower</b>	<b>Original 2010 decision</b> <p>Transpower may include in its RAB value finance leases and intangible assets, provided that they are identifiable non-monetary assets that are not goodwill, consistent with the meanings under GAAP. Transpower must establish the value of permitted intangible assets added to the RAB value after 30 June 2011 using the cost model for recognition under GAAP. Transpower may not include operating leases in its RAB value.</p> <p>See section 4.4, paragraphs 4.4.49-4.4.57, 4.4.64-4.4.67 of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

### *We propose implementation changes for this decision*

141. We considered IM decision AV25 together with IM decision AV05. Consistent with our proposed changes for IM decision AV05 applying to EDBs, GDBs and GTBs, we also propose changing the Transpower IMs to better implement IM decision AV25.
142. Specifically, we propose amending the application of the term ‘finance leases’ for the purposes of the RAB rules in the IMs to have the effect of excluding from the RAB any finance lease amounts treated under the IMs as recoverable costs. Our reasons for proposing this change are the same as those for the change we are proposing to IM decision AV05, which applies to EDBs and GPBs.

### Existing asset valuation IM decision AV33

<p><b>Decision AV33</b>  <b>Financing costs on works under construction – Transpower</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower must capitalise financing costs on works under construction in accordance with GAAP, at a rate no greater than the 75<sup>th</sup> percentile for the regulatory post-tax WACC determined under the cost of capital IM.</p> <p>When it commissions works under construction, Transpower must reduce the cost of the asset, established consistent with GAAP, by the amount of any revenue derived in relation to the assets while they were works under construction (where such a reduction is not already made under GAAP, and where the revenue has not already been reported as income under ID).</p> <p>See section 4.4, paragraphs 4.4.31 – 4.4. 48 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>Our final decision was to use the 67<sup>th</sup> percentile estimate of post-tax WACC as a limit, when determining the value of commissioned assets under particular provisions of the IMs. This change took effect as of the commencement dates specified in the amendment determination and discussed further below; it did not require subsequent changes to the ID requirements before suppliers were required to apply it.</p> <p><a href="#">Amendments to the WACC percentile range for information disclosure regulation for electricity lines services and gas pipeline services: Reasons Paper (12 December 2014)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Transpower</p>

#### *How we propose changing this decision*

143. In respect of IM decision AV33, we propose amending the IM decision to require Transpower to use its GAAP cost of financing, capped at its New Zealand dollar weighted average cost of borrowing, when calculating the cost of financing for assets under construction. We propose removing the WACC rate cap.

#### *Why we propose making this change*

144. We currently allow Transpower to account for the financing cost of the construction of assets in a manner which is consistent with GAAP, subject to a cap that prevents it from using a cost of financing that is higher than its WACC rate.

145. Transpower has argued that the WACC rate cap is problematic for it.<sup>47</sup> This is because Transpower uses long term debt and when interest rates decrease rapidly (as it has in the period since the global financial crisis), it faces debt rates for financing its construction that are higher than its WACC. This creates a compliance cost for Transpower, as the value of its assets under GAAP is then higher than the value of its assets for regulatory purposes. This means that it must either invest disproportionate amounts to maintain two fixed asset registers or apply a complex adjustment process to keep its asset values for GAAP and the IMs aligned.
146. As the cost of borrowing would generally be expected to be lower than the cost of equity (the other component of the WACC), there are few cases where we expect this situation to arise. Indeed, this does not seem to be an issue at the present time. Nonetheless, this situation did arise for a period following the global financial crisis and it is possible that a swift decrease in interest rates might cause it to arise again.
147. We are hesitant to allow the use of GAAP on an unconstrained basis for this purpose, for the reasons stated in the 2010 Reasons Paper.<sup>48</sup> We consider the better approach in the circumstances, which is consistent with our 2010 decision, would be to require Transpower to use its GAAP cost of financing, capped at its average cost of borrowing. This would give it an incentive to seek the most appropriate source of debt. The approach we propose is consistent with the approach most companies are likely to take in calculating their cost of financing under GAAP for this purpose, as few have project-specific debt (which would allow for a different treatment under GAAP accounting standards).

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<sup>47</sup> Letter from Jeremy Cain (Transpower) to Dane Gunnell (Senior Analyst, Commerce Commission) regarding amendments to Transpower Input Methodologies for RCP2 (14 June 2013), p. 5. Available at: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/amendments-and-clarifications/>.

<sup>48</sup> Commerce Commission "Input methodologies (Transpower) reasons paper" (December 2010), para. 4.4.41a.

148. We note that Transpower has stated that it does use the GAAP approach in setting a capitalisation rate for the purposes of capitalising its cost of financing its capital expenditure (**capex**).<sup>49</sup> The accounting standard applicable to Transpower under GAAP has the following features:<sup>50</sup>

- 148.1 to the extent that the company borrows funds generally and uses them for the purpose of capex, it determines the cost of financing eligible for capitalisation by applying a capitalisation rate to its capex projects;
- 148.2 the capitalisation rate is the weighted average of the borrowing costs applicable to the company's borrowings that are outstanding during the year, taking into account the costs or benefits of any hedging of borrowing of any included foreign currency funds; and
- 148.3 the amount of borrowing costs that the company capitalises to assets during a year must not exceed the amount of borrowing costs it incurred during that year.

#### Existing asset valuation IM decision AV35

<p><b>Decision AV35</b>  <b>Standard physical asset lives to apply with exceptions – Transpower</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower must use the standard physical asset lives in Schedule A of the IM Determination, with the following exceptions:</p> <ul style="list-style-type: none"> <li>• Transpower must depreciate fixed life easements over the expected term of the easement;</li> <li>• for dedicated assets, Transpower may assign an asset life equal to the life of the supporting customer contract;</li> <li>• Transpower may extend asset lives beyond those provided in the list of standard physical asset lives, and set asset lives for refurbished assets, without an independent engineer's report;</li> <li>• Transpower may reduce an asset life, provided the reduced asset life is supported to an independent engineer's report;</li> <li>• Transpower must determine when to start depreciating network spares consistent with GAAP;</li> </ul>
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<sup>49</sup> Letter from Jeremy Cain (Transpower) to Dane Gunnell (Senior Analyst, Commerce Commission) regarding amendments to Transpower Input Methodologies for RCP2 (14 June 2013), p. 5. Available at: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/amendments-and-clarifications/>.

<sup>50</sup> See: New Zealand Equivalent to International Accounting Standard 23 (NZ IAS 23), para 14.

- where Transpower adds a found asset to the RAB value, and where Transpower's RAB already contains a similar asset, the asset life of the found asset should be the asset life applying to the similar asset;
- for assets commissioned in the future that are not covered by the list of standard physical asset lives:
  - where an asset of the same type is already in the RAB, Transpower must use the same asset life as assigned to the existing asset; or
  - otherwise set asset lives for the assets, provided they are supported by an independent engineer's report.
- where an asset comprises a number of components with differing lives (a 'composite asset'), Transpower must calculate the total asset life for the composite asset as a weighted average of the lives of those components.

Total (unallocated) depreciation over the lifetime of the asset, must not exceed the value at which the asset is first recognised in the RAB under Part 4 (after adjusting for the effects of revaluations).

See section 4.4, paragraphs 4.4.109- 4.4.129 of 2010 Transpower IM reasons paper:

[Input Methodologies \(Transpower\) Reasons Paper \(22 December 2010\)](#)

#### **2014 amendment to this decision**

The amendment affects the IMs relating to ID regulation and individual price-quality regulation for Transpower. The new depreciation treatment applies to assets commissioned on or after 1 July 2015. The pseudo asset for the 2015–2020 regulatory control period (**RCP2**) is also established on that date. This corresponds to the commencement date of the first disclosure year for RCP2.

We amended the IMs governing asset valuation to allow depreciation to be calculated for assets in the year in which those assets are commissioned. Depreciation calculations under the existing IMs commences for regulatory purposes in the year *following* the year of commissioning of new assets.

The calculation of depreciation is pro-rated for the year to reflect the portion of the year that the assets are commissioned.

If the treatment had applied from 2011 when Transpower's initial RAB was determined then regulatory asset values in 2015 could be expected to be approximately \$50 million less. Transpower requested that its regulatory asset values be adjusted to eliminate this difference from 2015.

	<p>To achieve this in an NPV neutral manner the IMs require regulatory asset values to be decreased, and the amount of the decrease to be established as an 'RCP2 pseudo asset' as at the first day of the 2016 disclosure year. The pseudo asset will then be depreciated over a period of 31 years, which Transpower has advised is the average remaining asset life of affected assets.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<b>This original decision applies to (sector):</b>	Transpower

*We propose implementation changes for this decision*

149. We propose the following implementation changes for IM decision AV35:

- 149.1 amend the Transpower IM Determination so that the asset life of non-system assets is determined by applying the asset life used under GAAP;
- 149.2 amend the Transpower IM Determination to make it clear that asset lives are not reset on transfers of assets; and
- 149.3 amend the Transpower IM Determination so the value of an asset is adjusted for depreciation applying in the year of transfer.

*Why we propose making these changes*

150. We are proposing to make equivalent implementation changes in the IMs for EDBs, GDBs and GTBs by amending IM decision AV17. Our reasoning for making these changes to IM decision AV35 is the same as for IM decision AV17.

## Existing asset valuation IM decision AV40

<b>Decision AV40</b> <b>RAB roll forward with indexation – Airports</b>	<b>Original 2010 decision</b> Airports must roll forward the initial value of their non-land assets using consumer price index (CPI) indexation. For this purpose airports must use the 'All Groups Index SE9A' published by Statistics New Zealand. For each quarter prior to the December 2010 quarter, airports must multiply the CPI value from that index by 1.02, to adjust for the recent change in GST.  See section 4.3; Appendix C, section C13 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

### *How we propose changing this decision*

151. As discussed in Topic paper 5: Airports profitability assessment, our draft decision is to make a change to IM decision AV40 to:
  - 151.1 allow airports the opportunity to disclose forward- and backward-looking costs on a consistent basis to the approaches used when setting prices by allowing airports to revalue assets using either CPI-indexation or an un-indexed approach; and
  - 151.2 allow airports to make their choice of either CPI-indexation or an un-indexed approach for each subset of the asset base separately.
152. We also propose specifying the method of forecasting CPI that must be disclosed by airports in pricing disclosures. This method reflects the forecast CPI included in the Reserve Bank quarterly monetary policy statements and for later years, tends towards the mid-point of the Reserve Bank CPI target.
153. Our approach is consistent with the forecast of CPI included in the IMs relating to the setting of DPPs for electricity and gas. Note that these IM changes would also be supported by proposed changes to the relevant ID determinations, as also discussed in Topic paper 5: Airports profitability assessment.

## Existing asset valuation IM decision AV41

<p><b>Decision AV41</b>  <b>Initial RAB values for land assets and revaluation approach – Airports</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Airports:</p> <ul style="list-style-type: none"> <li>• must establish initial RAB values for their land assets, as on the last day of the disclosure year 2009, using the market value alternative use (<b>MVAU</b>) approach specified in Schedule A of the IM Determination;</li> <li>• can revalue airport land in their RAB value using an MVAU valuation approach, in accordance with Schedule A, in any disclosure year. For revaluations to be recognised in the RAB value, they must encompass all land held by the Airport in its RAB value. All future development land must be revalued using a MVAU approach as at the same date. In years in which no MVAU revaluation is undertaken, land in the RAB value and future development land must be CPI-indexed. For this purpose airports must use the ‘All Groups Index SE9A’ published by Statistics New Zealand (CPI values prior to December 2010 must be multiplied by 1.02).</li> </ul> <p>See section 4.3, Appendix C, sections C2 and C13 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>High Court judgment in <i>Wellington International Airports Ltd and others v Commerce Commission</i> [2013] NZHC 3289 (11 December 2013) and Commerce Commission “Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court” (27 November 2014). See amended clauses 3.2(1)(b) and 3.7(6)(c) of the Airports IM Determination:</p> <ul style="list-style-type: none"> <li>• amend the disclosure year for the ‘unallocated initial RAB value’ for land from ‘disclosure year 2009’ to ‘disclosure year 2010’; and</li> <li>• the ‘unallocated revaluation’ of land and ‘revaluation’ of land in disclosure year 2010 are nil.</li> </ul> <p><a href="#">Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court (27 November 2014)</a></p> <p><a href="#">Wellington International Airport Ltd &amp; Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013]</a></p>
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	<p><b>2016 amendment to this decision (2)</b></p> <p>We decided to incorporate the latest valuations standards by reference into Schedule A of the Airport IMs.</p> <p>We amended Schedule A of the Airport IMs to provide additional direction on the information required to be included in the valuer’s report in order to support the valuation. The additional information includes:</p> <ul style="list-style-type: none"> <li>• where material to the valuation, economic analysis to support the highest and best alternative use (<b>HBAU</b>) plan;</li> <li>• other expert opinions obtained by the valuer, where the valuer is not suitably experienced or qualified to provide an expert opinion;</li> <li>• information to support the value of rezoning costs included in the MVAU; and</li> <li>• all material assumptions and special assumptions made in undertaking the valuation.</li> </ul> <p>“The amendments introduced through [the] fast track process are intended to clarify that the treatment of remediation costs also applies to the costs associated with rezoning airport land. In particular, in determining the MVAU of the land, it is assumed that airport zoning does not apply.</p> <p>Our decision is to remove any inconsistencies in, and repetition between, and within, the Schedule A requirements, explanatory notes and reference statements.</p> <p>Market-based evidence for estimating the eventual gross realisations or estimated value of the land can only be used to the extent that the use is unaffected by the supply of specified airport services.”</p> <p><a href="#">Input methodologies review – Amendments to input methodologies for airports land valuation – Final reasons paper for the airports fast track review (24 February 2016)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Airports</p>

*How we propose changing this decision*

154. As discussed in Topic paper 5: Airports profitability assessment, our draft decision is to make a change to IM decision AV41 by introducing a pragmatic proxy for the initial RAB value for land as at 2010, by interpolating 2009 and 2011 RAB land values based on existing MVAU valuations.
155. These IM changes would also be supported by proposed changes to the relevant ID determinations, as also discussed in Topic paper 5: Airports profitability assessment.

156. Our draft decision would change IM decision AV41 by amending the mechanism for determining the unallocated initial RAB value of land in the Airports IM Determination to:
  - 156.1 no longer determine the value as on the last day of the disclosure year 2010 in accordance with the Airports Land Valuation Methodology; and
  - 156.2 instead, determine the value by using a proxy for the initial RAB value as at 2010 by interpolating 2009 and 2011 RAB land values based on existing MVAU valuations.
157. In addition, we propose specifying the method of forecasting CPI that must be disclosed by airports in pricing disclosures, for the same reasons as discussed under IM decision AV40.

## Existing asset valuation IM decision AV42

<p><b>Decision AV42</b>  <b>RAB exclusions –</b>  <b>Airports</b></p> <p><b>(original 2010</b>  <b>decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Airports should exclude from their RAB values:</p> <ul style="list-style-type: none"> <li>• any assets not used to provide specified airport services, as defined in s 56A;</li> <li>• future development land;</li> <li>• any asset that is part of works under construction;</li> <li>• working capital;</li> <li>• goodwill; and</li> <li>• easement land, that is land acquired for the purpose of creating an easement, and with the intention of subsequently disposing of the land.</li> </ul> <p>See section 4.3; Appendix C, sections C3, C4, C5, C10 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>High Court judgment in <i>Wellington International Airports Ltd and others v Commerce Commission</i> [2013] NZHC 3289 (11 December 2013) and Commerce Commission “Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court” (27 November 2014). See amended clause 3.12(3) of the Airports IM Determination:</p> <p>For the purpose of land that is works under construction on the last day of disclosure year 2009, Auckland International Airport’s cost of constructing the Northern Runway must not exceed \$22.3 million.</p> <p><a href="#">Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court (27 November 2014)</a></p>
<p><b>This original decision</b>  <b>applies to (sector):</b></p>	<p>Airports</p>

### *How we propose changing this decision*

158. As discussed in Topic paper 5: Airports profitability assessment, our draft decision is to make a change to IM decision AV42 by amending the definition of net revenue on excluded assets (in particular, in relation to assets held for future use—eg, future development land). This would ensure that if an airport included revenues on assets held for future use through a special levy, this would be captured in the definition of net revenue and not included as regulatory income.

159. This proposed IM change would also be supported by proposed changes to the ID determination, as also discussed in Topic paper 5: Airports profitability assessment.
160. Our draft decision would change the definition of “net revenue” in clause 3.11(6)(c) of the Airport IMs to make the policy intent clearer (ie, all revenues derived from or associated with assets held for future use would be captured in the definition of net revenue).

*We also propose an implementation change for this decision*

161. We also propose to make a change to the IMs to improve the IM decision AV42 is implemented.
162. We propose changing the adjustment to the value of excluded assets to net after-tax revenue rather than net pre-tax revenue. This would ensure that when an excluded asset is commissioned and forms part of the RAB, the commissioned value of the asset would correctly reflect the post-tax cost of commissioning the asset.

*Why we are proposing this implementation change*

163. Auckland Airport raised an issue about the treatment of assets held for future use which are considered excluded assets (such as land held for future use) in the IMs.<sup>51</sup>
164. We use a post-tax WACC to calculate the value of excluded assets whereas net revenue is calculated on a pre-tax basis. This means that under the IMs as they are currently implemented, an asset ultimately gets transferred to a RAB value which is lower than the post-tax cost of commissioning of the asset (after adjusting for net income). This difference is equal to the tax paid on the net revenue derived from the excluded asset.
165. Auckland Airport may choose to include revenues associated with excluded assets relating to its proposed second runway in advance of the runway being commissioned when setting prices at its next price setting event. We consider there is value in using the roll forward of excluded assets as a method of accounting for forecast revenues associated with the second runway on an ex-ante basis in ID. However, Auckland Airport has indicated that it will not elect to use this approach if the IM is not appropriately amended to address the tax issue.<sup>52</sup>

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<sup>51</sup> Auckland Airport “Problem definition for input methodologies review: submission to Commerce Commission” (21 August 2015), para. 70.

<sup>52</sup> Auckland Airport “Problem definition for input methodologies review: submission to Commerce Commission” (21 August 2015), para. 70.

166. Since land is not depreciated over time (and is treated independent of additions to the RAB), it is not possible for airports to recover the tax they have incurred on revenue derived from the excluded asset through a depreciation charge. We consider the most practical way to address this issue would be to change the definition of 'net revenue' for this purpose to reflect it on an after-tax basis.

*Issues we have considered where no change is proposed*

167. Auckland Airport has recently raised a concern about whether the IMs unintentionally cause holding costs for works under construction to be treated as excluded costs.<sup>53</sup> We have considered this issue, but do not currently propose any changes in response.
168. When an 'asset held for future use' becomes a 'works under construction', its cost is calculated in accordance with the IMs, but is split into two components:
- 168.1 cost of land equals the base value of the land (its original MVAU value as at 2010 plus tracking revaluations since then); and
- 168.2 cost of property due to the incursion of land conversion costs is defined in the formula:
- $$\begin{aligned} & \text{Cost of property due to the incursion of land conversion costs} \\ & = \text{Holding costs} - \text{net revenue} - \text{tracking revaluations} \end{aligned}$$
169. This means that the base value of assets held for future use increases with revaluations, but does not increase with holding costs. These are tracked separately and transferred to works under construction as a separate cost to the land itself, and treated as the "cost of property due to the incursion of land conversion costs". However, "property due to the incursion of land conversion costs" is itself defined as an excluded asset – with the exception of Auckland Airport's sea wall.
170. In Auckland Airport's view, it is not clear how the holding costs can be recovered at the time the asset is commissioned.<sup>54</sup> The IMs suggest that these costs are an excluded asset that cannot be added to the RAB.
171. We are aware of this issue but, as it has only been raised recently, we have not had sufficient time to assess its merit. However, we invite submissions on this issue and anticipate forming a view on this between our draft and final decisions.

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<sup>53</sup> Email and attachment from Emma Rae (Senior Advisor, Auckland Airport) to Jo Perry (Senior Analyst, Commerce Commission) raising issues with assets held for future use (4 May 2016), section C. The email and attachment are available on our website at: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/airport-profitability-assessment/>.

<sup>54</sup> Email and attachment from Emma Rae (Senior Advisor, Auckland Airport) to Jo Perry (Senior Analyst, Commerce Commission) raising issues with assets held for future use (4 May 2016), section C.

## Existing asset valuation IM decision AV48

<b>Decision AV48</b> <b>Capital contributions and vested assets – Airports</b>	<b>Original 2010 decision</b> <p>Airports must recognise capital contributions by adding the asset in question to the RAB value at cost (measured in accordance with GAAP), reduced by the amount of the capital contribution received (where the capital contribution does not reduce the cost of the asset under GAAP).</p> <p>Airports must include vested assets in the RAB value at the cost to the Airport. The cost at which the asset enters the RAB value may not exceed the amount of consideration paid by the Airport in respect of that asset.</p> <p>See Appendix C section C9, of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

### *We propose implementation changes for this decision*

172. Consistent with an implementation change proposed for IM decision AV09, we propose making the following implementation changes for this IM decision:
- 172.1 Expand the definition of ‘capital contributions’ to include money received in respect of asset acquisitions.
  - 172.2 Amend the IMs so that the calculation of the financing cost that can be capitalised in the RAB on a commissioned asset is based on a value of works under construction that is net of capital contributions at any stage. This would include any situation where a capital contribution is received before money is spent on the works.

### *Why we propose making these changes*

173. Our reasons for proposing these implementation changes to IM decision AV48 are the same as our reasons for the implementation changes we are proposing for IM decision AV09.
174. The current definition of ‘capital contributions’ is consistent between the EDB, GDB, GTB and Airports IMs. The way in which financing costs are calculated and capitalised to the RAB is also similar in these IMs currently.

**Existing asset valuation IM decision AV50**

<b>Decision AV50</b> <b>Straight line depreciation applies with election to use non-standard approach – Airports</b>	<b>Original 2010 decision</b> Airports must depreciate their assets on a straight line basis, unless they elect to use a non-standard depreciation approach (subject to the ID Determination). No depreciation is to be applied to land and easements (other than fixed life easements).  See Appendix C, section C11 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

*We propose an implementation change for this decision*

175. As discussed in Topic paper 5: Airports profitability assessment, in respect of IM decision AV50, our draft decision is to make an implementation change to improve the effectiveness of the existing decision.
176. Specifically, we propose supplementing the existing non-standard depreciation rules in the IMs with principles to help guide the application of the provisions. The reasons for this proposed change are provided in Topic paper 5: Airports profitability assessment.
177. These IM changes would also be supported by proposed changes to the relevant ID determinations, as also discussed in Topic paper 5: Airports profitability assessment.

## Proposed new asset valuation IM decision AV55

178. We propose a new asset valuation IM decision AV55 as follows:

<b>Decision AV55</b> <b>Giving effect to IM decisions – applying alternative methodologies with equivalent effect – Airports</b>	<p><b>Proposed new 2016 decision</b></p> <p>To give effect to existing IM decisions, we propose to allow alternative methodologies with equivalent effect (<b>AMWEEs</b>) to be available to airports in addition to the existing methodologies for disclosing information under ID, provided the alternative methodologies produce an equivalent effect to the existing IMs.</p> <p>Alternative methodologies can only be applied in place of the roll forward of the RAB for capex, disposals, depreciation and revaluations specified in the asset valuation IMs.</p> <p>We have specified the criteria that must be met in order for alternative methodologies to be applied, and the information required to be provided by an airport to demonstrate that it meets the specified criteria.</p>
<b>This decision applies to (sector):</b>	Airports

### *We propose a new IM decision*

179. As discussed in Topic paper 5: Airports profitability assessment, we have proposed that airports may apply alternative asset valuation IMs with equivalent effect when making disclosures under ID.
180. We have specified the criteria that must be met in order for alternative methodologies to be applied, and the information required to be provided by an airport to demonstrate that it meets the specified criteria.

### *Reasons for the proposed new decision*

181. We are proposing this new decision because it may be more appropriate or cost effective for an airport to have the option to establish and roll forward the value of the RAB based on using an aggregated RAB rather than having to establish the RAB on an individual asset basis (as is currently required in the asset valuation IMs in the Airports IM Determination). The reasons for this proposed change are provided in Topic paper 5: Airports profitability assessment.
182. This proposed IM change would also be supported by proposed changes to the Airports ID determination, as also discussed in Topic paper 5: Airports profitability assessment.

## Chapter 6: Treatment of taxation decisions we propose changing

### Existing treatment of taxation IM decision TX01

<b>Decision TX01</b> <b>Modified deferred tax approach applies – EDBs and GDBs</b>	<b>Original 2010 decision</b> Tax costs must be estimated using a ‘modified deferred tax’ approach.  Specification of modified deferred tax approach (eg, how the deferred tax balance is calculated and cost allocation adjustments are treated).  See section 5.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB

#### *We propose an implementation change for this decision*

183. In respect of IM decision TX01, our draft decision is to make a change to the IMs to improve the way the existing determination is implemented.
184. We propose amending the EDB and GDB IM Determinations so that the ID and CPP IM calculation for closing deferred tax includes an adjustment for asset disposals.

#### *Why we propose making this change*

185. ENA and PwC submitted that the EDB IM closing deferred tax provisions should include asset disposals to align with the EDB ID requirements, which include an adjustment for disposals in their closing deferred tax calculation.<sup>55</sup>
186. The EDB ID and GDB ID determinations define ‘closing deferred tax’ by reference to the definition in the IMs. The IM formulae have no adjustment for the deferred tax in respect of asset disposals. However, ‘closing deferred tax’ in the EDB ID and GDB ID determinations do.
187. As ‘deferred tax balance relating to assets disposed in the disclosure year’ is a subtracted part of the ‘closed deferred tax’ calculation in the ID schedules, and to improve consistency between the determinations, it should also be subtracted in the deferred tax formulae in the EDB and GDB IM Determinations. The reference to the IMs in each ID determination definition of ‘closing deferred tax’ would then remain consistent and relevant.

<sup>55</sup> ENA and PwC “Review of input methodologies” (14 February 2014), para 6.

188. Because the GTB, Airports and Transpower IMs do not include deferred tax in their tax calculations (ie, they all use the ‘tax payable’ method of calculation of tax), we do not propose amending those IM determinations for asset disposals.

*Issues we have considered where no change is proposed*

189. Our draft decision in respect of IM decision TX01 is to make no change with respect to the treatment of deferred taxation following the transfer of assets.
190. We are proposing no changes in respect of this issue because the treatment of tax is different between the Transpower and EDB IM Determinations, which may create issues for determining the regulatory investment value in spur asset transfers from Transpower to an EDB.
191. We do not propose amending the EDB IM Determination for spur asset transfers. As such, the opening deferred tax an EDB uses in its regulatory investment value calculation will be zero.
192. Having no opening deferred tax value means that when an EDB calculates its regulatory investment value, it will use the opening RAB value provided by Transpower for the spur asset and will not need to estimate the opening deferred tax value.
193. We have provided the guidance in the above paragraph, rather than proposing an amendment to the EDB IM Determination. This is because spur asset transfers are uncommon and we do not wish to create additional complexity by unnecessarily amending the tax IM requirements.

**Existing treatment of taxation IM decision TX04**

<b>Decision TX04</b> <b>Regulatory tax asset value of asset acquired</b>	<b>Original 2010 decision</b> The regulatory tax asset value of acquired assets should remain unchanged in the event of an acquisition of assets used to supply services that are regulated under Part 4.  See Appendix G of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*We propose an implementation change for this decision*

194. In respect of IM decision TX04, our draft decision is to make a change to the IMs to improve the way the existing decision is implemented.

195. We propose an implementation change to address the tax effect on capital contributions in the applicable clauses of the EDB, GDB and GTB IM Determinations when an asset is bought or sold between suppliers, so that those clauses include the phrase:

limited to its **value of commissioned asset** or, if relevant **capital contributions** are treated for tax purposes in accordance with section CG 8 of the Income Tax Act 2007 (or subsequent equivalent provisions), limited to the **value of commissioned asset** plus any **capital contributions** applicable to the asset.

196. The same implementation change is proposed for the Airports IM Determination, as a proposed change to IM decision TX20.

*Why we propose making this change*

197. The proposed amendment provides a common sense adjustment where EDBs, GPBs and airports are at risk of incorrectly recovering an amount of tax, and is generally consistent with a submission from PwC and ENA in February 2014.<sup>56</sup>
198. PwC and ENA suggested amending the relevant clauses of the EDB ID and CPP IMs to now include the wording:<sup>57</sup>

limited to its value of commissioned asset, unless the EDB treats capital contributions under section CG 8 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.

199. We generally agree with this position, but have further clarified the suggested drafting. We consider that the value impact on the amount of revenue recoverable from customers adds further clarity on the operation of s CG 8 of the Income Tax Act 2007 when applying the IMs.
200. Because the Transpower IMs do not have rules relating to capital contributions, we do not propose amending the Transpower IM to reduce the risk of incorrectly recovering the amount of tax that is applicable for EDBs, GPBs and airports.<sup>58</sup>

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<sup>56</sup> ENA and PwC "Review of input methodologies" (14 February 2014), para 7.

<sup>57</sup> ENA and PwC "Review of input methodologies" (14 February 2014), para 7.

<sup>58</sup> *Transpower Input Methodologies Determination 2012* [2012] NZCC 17.

## Existing treatment of taxation IM decision TX08

<p><b>Decision TX08</b> Tax legislation and cost allocation to be applied – GDBs and GTBs</p> <p>(original 2010 decision amended)</p>	<p><b>Original 2010 decision</b></p> <p>When calculating regulatory taxable income, the cost allocation IM and tax legislation (to the extent practicable) are to be used, subject to other relevant provisions in the IMs. Debt interest should be calculated using a notional leverage that is consistent with the cost of capital IM.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2013 amendments to this decision</b></p> <p><i>Definition of notional deductible interest</i></p> <p>This amendment changes the definition of notional deductible interest used in the treatment of taxation IMs to apply a mid-year cash-flow timing assumption to the calculation of notional interest amounts. The current IMs assume year-end payments rather than payments being made during the year.</p> <p><i>Correction to double deduction of TCSD allowance</i></p> <p>This amendment corrects the double deduction of the TCSD allowance when calculating the regulatory tax allowance for the treatment of taxation IMs for DPPs.</p> <p>The TCSD is included as a deduction in the definitions of both the regulatory profit/(loss) before tax and the regulatory tax adjustments and clause 4.3.1 uses these two terms to derive the regulatory tax allowance. As a result, the TCSD allowance is incorrectly deducted twice when calculating the regulatory tax allowance.</p> <p><a href="#">Amendments to input methodologies for gas distribution and transmission services: Reasons paper (26 February 2013)</a></p>
<p><b>This original decision applies to (sectors):</b></p>	<p>GDB/GTB</p>

### *We propose an implementation change for this decision*

201. In respect of IM decision TX08, our draft decision is to make a change to the IMs to improve the way the existing decision is implemented.
202. We propose aligning the ‘amortisation of initial differences’ provisions in the GDB DPP IM to the language used in the EDB DPP IM ‘regulatory tax adjustments’ provisions.

*Why we propose making this change*

203. As part of the 27 November 2014 EDB IM amendments, we corrected the definition of “amortisation of initial differences in asset values” in the EDB DPP tax IM to take account of the changes in initial difference in values that result from the age, sale and acquisition of relevant assets.<sup>59</sup>
204. Currently the “Regulatory tax adjustments” provisions of the GDB DPP tax IM contain the language used in the EDB tax IM as it was before our 27 November 2014 amendments.<sup>60</sup>
205. To improve consistency between the EDB and GDB DPP tax IMs, we propose amending the GDB DPP tax IM “amortisation of initial differences” clauses to use the same language as in the updated EDB DPP tax IM.<sup>61</sup>

*Issues we have considered where no change is proposed*

Definition for ‘weighted average remaining useful life of relevant assets’

206. We have considered ENA and PwC’s submission on the issue of whether the definition for ‘weighted average remaining useful life of relevant assets’ needs to be defined in the IM determinations.<sup>62</sup> We do not consider a change is required.
207. We consider that the ID requirements provide appropriate guidance to interpret the term and we have decided not to change the IMs in this regard. Our guidance to suppliers is to use the EDB and GDB ID definition of “opening weighted average remaining useful life of relevant assets (years)” when applying the term “weighted average remaining useful life of relevant assets” in the EDB and GDB IM Determinations.

Requirements for tax information to be disclosed by entities not subject to income tax

208. MDL submitted that it has problems applying the IM requiring tax information to be disclosed.<sup>63</sup> MDL is not subject to income tax, so cannot provide the relevant tax information required by the IM. Nevertheless, we do not propose any changes to the IMs for this issue.
209. The issue identified by MDL arises from its pre-existing joint venture structure. However, MDL will soon cease to supply regulated services under this structure. All current GTB services provided by the Maui joint venture will be provided by a single entity under the new First Gas ownership.

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<sup>59</sup> Commerce Commission “Input Methodology amendments for electricity distribution services: Default price-quality paths” (27 November 2014), paras 4.1-4.9.

<sup>60</sup> *Gas Distribution Services Input Methodologies Determination 2012* [2012] NZCC 27, clause 4.3.3.

<sup>61</sup> *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26, clause 4.3.3.

<sup>62</sup> ENA and PwC “Review of input methodologies” (14 February 2014), para 17.

<sup>63</sup> MDL, Untitled submission on problem definition paper (21 August 2015), p. 14.

210. While an acceptable substitute for the required tax information will need to be provided by First Gas for the upcoming GTB DPP reset, there no longer appears to be any benefit to changing the IMs in response to this issue.

#### Existing treatment of taxation IM decision TX20

<b>Decision TX20</b> <b>Regulatory tax asset value of asset acquired from another supplier- Airports</b>	<b>Original 2010 decision</b> <p>The regulatory tax asset value of assets acquired from another airport or from a supplier of another type of regulated service should remain unchanged in the event of an acquisition of assets used to supply services under Part 4.</p> <p>See Appendix D, section D2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

#### *We propose an implementation change for this decision*

211. In respect of IM decision TX20, our draft decision is to make a change to the IMs to improve the way the existing decision is implemented.
212. We propose making the same implementation change to address the tax effect on capital contributions in the applicable clauses of the Airports IM Determination when an asset is bought or sold between suppliers as we have proposed for EDBs, GDBs and GTBs under IM decision TX04.

#### *Why we propose making this change*

213. Our reasons for proposing this implementation change are the same as those set out for proposed amendments to IM decision TX04.

## Chapter 7: Cost of capital decisions we propose changing

### Existing cost of capital IM decision CC03

<p><b>Decision CC03</b>  <b>Commission to publish annual WACC estimates</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>The Commission will publish annually for all regulated suppliers:</p> <ul style="list-style-type: none"> <li>• a mid-point estimate of the 5-year post-tax WACC and vanilla WACC to apply under ID regulation; and</li> <li>• an estimate of 5-year vanilla WACC at the 75<sup>th</sup> percentile to apply in setting DPPs and CPPs under default/customised price-quality regulation.</li> </ul> <p>Three- and 4-year equivalent estimates of the vanilla WACC at the 75<sup>th</sup> percentile will also be published as required for CPPs, and estimated WACC ranges for the 25<sup>th</sup> to the 75<sup>th</sup> percentiles for both the post-tax WACC and the vanilla WACC will be published to inform interested persons.</p> <p>See sections 6.7, H14 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>This amendment gives effect to the Commission's decision to move from using the 75<sup>th</sup> percentile estimate of WACC to the 67<sup>th</sup> percentile estimate of WACC for the purposes of price-quality regulation for electricity lines services and gas pipeline services. This amendment does not amend the WACC percentile range used for ID regulation. Our decision was that the specified WACC for EDBs, Transpower and GPBs should be amended, in light of evidence we gathered since the IMs were first determined in December 2010. Our decision was that the 67<sup>th</sup> percentile of our estimated WACC distribution should be used for price-quality path regulation (the 75<sup>th</sup> percentile is currently used). Our decision was given effect to by amending the cost of capital IMs applying to those businesses.</p> <p>This amendment to the WACC percentile applies to EDBs on a DPP and to Transpower's IPP when the resets of those price-quality paths take effect in 2015.</p> <p><a href="#">Amendment to the WACC percentile for price-quality regulation for electricity lines services and gas pipeline services: Reasons paper (30 October 2014)</a></p>
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	<p><b>2014 amendment to this decision (2)</b></p> <p>Our decision was not to amend the 25<sup>th</sup> to 75<sup>th</sup> percentile range for ID for electricity lines services and gas pipeline services. These percentile estimates of WACC continue to be determined and published annually, along with the mid-point estimate (which is also currently published annually). In addition, we annually determine and publish 67<sup>th</sup> percentile estimates so that these are available to ourselves and other interested persons to be used in analysing the performance of suppliers.</p> <p><a href="#">Amendments to the WACC percentile range for information disclosure regulation for electricity lines services and gas pipeline services: Reasons Paper (12 December 2014)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*How we propose changing this decision*

214. As discussed in Topic paper 4: Cost of capital issues, our draft decision is to make a change in respect of IM decision CC03. The proposed change is to no longer publish a specific CPP WACC. Also, we propose that the WACC used for CPPs be the prevailing DPP WACC (see also IM decision RP02, which would apply where the DPP WACC changes during the course of the CPP).
215. The reasons for this proposed change are discussed in Topic paper 4: Cost of capital issues.

*Issues we have considered where no change is proposed*

216. We have also considered a submission from MDL, which suggested that we should change our approach to setting the WACC to account for individual business needs.<sup>64</sup>
217. We do not consider that this is an issue requiring changes to the IMs. The policy intent is that the WACC should apply on an industry-wide basis, and we do not consider that changing this policy decision would better promote s 52A.
218. Note that a change in ownership of the MDL assets is likely to remove this issue in the future – ie, there will no longer be a bare nominee company with three separate shareholders supplying gas transmission services.

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<sup>64</sup> MDL, Untitled submission on cost of capital update paper (5 February 2016).

### Existing cost of capital IM decision CC05

<p><b>Decision CC05</b>  <b>Cost of debt in WACC estimates</b></p>	<p><b>Original 2010 decision</b></p> <p>For all regulated suppliers, the cost of debt is estimated as:</p> <p style="text-align: center;"><i>risk free rate + debt premium + debt issuance costs</i></p> <ul style="list-style-type: none"> <li>• the risk free rate is estimated by the Commission as part of publishing annual WACCs for all regulated suppliers. The risk free rate is estimated from the observed market yield to maturity of benchmark vanilla New Zealand Government NZ\$ denominated nominal bonds with a term to maturity that matches the term of the regulatory period (typically 5 years);</li> <li>• the debt premium is also estimated by the Commission as part of publishing annual WACCs for all regulated suppliers as the difference between the risk free rate and the yield on publicly traded corporate bonds for EDBs and GPBs with a Standard and Poor's (<b>S&amp;P</b>) long-term credit rating of BBB+ and a term to maturity which matches the regulatory period (typically 5 years); and</li> <li>• debt issuance costs are 35 basis points (0.35%) p.a.</li> </ul> <p>See sections 6.3; H2, H4, H5, H14 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

*How we propose changing this decision*

219. As discussed in Topic paper 4: Cost of capital issues, in respect of IM decision CC05, our draft decision is to change:
- 219.1 the risk-free rate – we propose continuing the use of the prevailing risk-free rate, but using 3 months of data instead of 1 month;
- 219.2 the debt premium – we propose modifying the current implementation:
- 219.2.1 to use 3 months of data instead of 1 month;
- 219.2.2 to remove the Government ownership limitation; and
- 219.2.3 to reference the ‘Nelson-Siegel-Svensson curve’ (**NSS curve**) as something we will consider when estimating the debt premium;
- 219.3 issuance costs – we propose changing this from 35 basis points (0.35%) p.a. to 20 basis points (0.20%) p.a.; and
- 219.4 swap costs – we propose removing an allowance for swap costs from the TCSD and instead include it in the above value of debt issuance costs (see also IM decision CC06).
220. We do not propose changing the credit rating.
221. The reasons for our draft decision in respect of IM decision CC05 are provided in Topic paper 4: Cost of capital issues.

**Existing cost of capital IM decision CC06**

<p><b>Decision CC06</b>  <b>Term credit spread differential allowance may apply</b></p>	<p><b>Original 2010 decision</b></p> <p>A separate TCSD allowance is calculated for qualifying suppliers reflecting the additional costs associated with holding a longer-term debt portfolio. The TCSD is used to adjust cash flows in ID and DPP regulation and is applied to allowable revenue calculations in CPP regulation.</p> <p>Qualifying suppliers are suppliers which have a debt portfolio with a weighted average original tenor exceeding the length of the regulatory period.</p> <p>See sections 6.1, 6.3, H6 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

*We propose making an implementation change for this decision*

222. As discussed in Topic paper 4: Cost of capital issues, our draft decision is to make an implementation change in respect of IM decision CC06.
223. The proposed change is to use a fixed linear relationship to determine the additional debt premium associated with debt issued with an original maturity term of more than 5 years. In doing so, we propose no longer including an allowance for swap costs as part of the TCSD (see IM decision CC05 above).
224. The reasons for this proposed change are discussed in Topic paper 4: Cost of capital issues.

*We propose an alternative implementation change if the proposed change above is not confirmed*

225. If the proposed change noted at paragraph 223 does not become our final decision, we propose instead amending the TCSD inputs for EDBs and GPBs, as per the amendment we made to the Transpower IMs in October 2015, to provide an accepted alternative with equivalent effect to the Bloomberg 'A' curve.<sup>65</sup> We would identify a suitable replacement method for determining a generic yield for an A-rated NZ bond.
226. Some of the inputs used to determine the TCSD in the EDB, GDB and GTB IM Determinations are derived from the 'Bloomberg New Zealand 'A' fair value curve'. The Bloomberg 'A' fair value curve is specifically referenced in the IM determination. However, this series has been discontinued by Bloomberg and Bloomberg has not replaced it with a similar series.

*Issues we have considered where no change is proposed*

227. ENA and PwC suggested that the IMs for EDBs and GPBs be changed to make it clear that the most recently published financial statements used to define a qualifying supplier are those published most recently prior to disclosure of the TCSD allowance under ID.<sup>66</sup>
228. We do not consider this is an issue that requires changes to the IM determinations. We consider that it is already clear from the IM determinations that the most recently published financial statements used to define a qualifying supplier are those published most recently prior to disclosure of the TCSD allowance under ID.

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<sup>65</sup> *Transpower Input Methodologies Determination 2012* [2012] NZCC 17.

<sup>66</sup> ENA and PwC "Review of Input Methodologies" (14 February 2014), para 27.

## Existing cost of capital IM decision CC07

<p><b>Decision CC07</b> Cost of equity in WACC estimates</p>	<p><b>Original 2010 decision</b></p> <p>Cost of equity is estimated using the simplified Brennan-Lally Capital Asset Pricing Model (<b>CAPM</b>) as:</p> $\text{risk free rate} \times (1 - \text{investor tax rate}) + \text{equity beta} \times \text{TAMRP}$ <ul style="list-style-type: none"> <li>• the risk free rate is the same as for the cost of debt;</li> <li>• the equity beta for EDBs and Transpower is 0.61 and for GPBs is 0.79, derived from: <ul style="list-style-type: none"> <li>○ an asset beta for EDBs of 0.34 and for GPBs of 0.44; and</li> <li>○ leverage of 44% for EDBs and GPBs;</li> </ul> </li> <li>• the investor tax rate is the maximum prescribed investor tax rate under the Portfolio Investment Entities (<b>PIE</b>) tax regime, which is 30% until 30 September 2010 and 28% thereafter. Changes in the prescribed rate will flow through to future WACC estimates automatically; and</li> <li>• The tax adjusted market risk premium (<b>TAMRP</b>) is 7.5% until 30 June 2011 and 7% thereafter. The TAMRP is expressed as a 5-year composite rate (to match the term of the regulatory period), hence the TAMRP estimated for the 5-year period which commences on 1 July 2010 is 7.1% and for the 5-year period which commences on 1 July 2011 is 7%.</li> </ul> <p>See sections 6.3 to 6.6; H2 to H10 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

*How we propose changing this decision*

229. As discussed in Topic paper 4: Cost of capital issues, in respect of IM decision CC07, our draft decision is to make changes to:
- 229.1 the equity beta estimate for EDBs – we propose changing this from 0.61 to 0.58;
  - 229.2 the equity beta estimate for GDBs and GTBs – we propose changing this from 0.79 to 0.58;
  - 229.3 the asset beta estimate for GDBs and GTBs – we propose changing this from 0.44 to 0.34 (because we propose changing the asset beta adjustment for GDBs and GTBs from 0.1 to 0). The asset beta estimate for EDBs would remain at 0.34;
  - 229.4 the leverage estimate for EDBs and GPBs – we propose changing this from 44% to 41%; and
  - 229.5 our approach for calculating the asset beta – we propose updating the comparator sample and then estimating an average asset beta looking at 4-weekly (rather than the current monthly) and weekly estimates over the two most recent 5-year periods.
230. We propose that the TAMRP remains at 7%.
231. The reasons for our draft decision in respect of IM decision CC07 are provided in Topic paper 4: Cost of capital issues.

## Existing cost of capital IM decision CC15

<p><b>Decision CC15</b>  <b>Cost of debt in WACC estimates – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>For all regulated suppliers, cost of debt is estimated as:</p> <p style="text-align: center;"><i>risk free rate + debt premium + debt issuance costs</i></p> <ul style="list-style-type: none"> <li>• the risk free rate of return is estimated by the Commission as part of publishing annual WACCs for all regulated suppliers. The risk free rate is estimated from the observed market yield to maturity of vanilla NZ Government NZ\$ denominated nominal bonds with a term to maturity that matches the term of the regulatory period (5 years);</li> <li>• the debt premium is also estimated by the Commission as part of publishing annual WACCs for all regulated suppliers as the difference between the risk free rate and the yield on publicly traded corporates bonds for EDBs and GPBs with a BBB+ S&amp;P long-term credit rating and a term to maturity which matches the regulatory period (5 years); and</li> <li>• debt issuance costs are 35 basis points (0.35%) p.a.</li> </ul> <p>See sections 6.3, H2, H4, H5 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

*How we propose changing this decision*

232. As discussed in Topic paper 4: Cost of capital issues, in respect of IM decision CC15, our draft decision is to make changes to:
- 232.1 the risk-free rate – we propose to continue using the prevailing risk-free rate, but to use 3 months of data instead of 1 month;
  - 232.2 the debt premium – we propose modifying the current implementation:
    - 232.2.1 to use 3 months of data instead of 1 month;
    - 232.2.2 to remove the government ownership limitation; and
    - 232.2.3 to reference the NSS curve as something we would consider when estimating the debt premium;
  - 232.3 issuance costs – we propose changing this from 35 basis points (0.35%) p.a. to 20 basis points (0.20%) p.a.; and
  - 232.4 swap costs – we propose removing an allowance for swap costs from the TCSD. It would instead be included in the above value of debt issuance costs (see IM decision CC16).
233. We do not propose changing the credit rating.
234. The reasons for our draft decision in respect of IM decision CC15 are provided in Topic paper 4: Cost of capital issues.

## Existing cost of capital IM decision CC16

<p><b>Decision CC16</b></p> <p><b>Term credit spread differential allowance may apply – Transpower</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>A separate TCSD allowance is calculated for qualifying suppliers reflecting additional costs associated with holding a longer-term debt portfolio. The TCSD is used to adjust cash flows in ID and individual price-quality regulation and is applied to allowable revenue calculations in the IPP. Qualifying suppliers have a debt portfolio with a weighted average original tenor exceeding the regulatory period (5 years).</p> <p>See sections 6.1, 6.3, H6 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>The implementation of the 2010 decision for the TCSD allowance uses the Bloomberg New Zealand ‘A’ fair value curve, which is no longer produced by Bloomberg.</p> <p>In 2014 we changed the implementation of this decision to allow use of the New Zealand Dollar Interest Rate Swap Curve as reported by Bloomberg plus the mean of the credit spreads of New Zealand corporate ‘A-band’ rated bonds as reported by Bloomberg.</p> <p>See page 15 of the companion paper that accompanied the amendment to the Transpower IM Determination:</p> <p><a href="#">Companion Paper to the Update of Transpower’s Maximum Allowable Revenues for the 2016/17 to 2019/20 Pricing Years</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

### *How we propose changing this decision*

235. As discussed in Topic paper 4: Cost of capital issues, our draft decision is to make an implementation change in respect of IM decision CC16.
236. The proposed change is to use a fixed linear relationship to determine the additional debt premium associated with debt issued with an original maturity term of more than 5 years. In doing so, we propose to no longer include an allowance for swap costs as part of the TCSD (see IM decision CC15).
237. The reasons for this proposed change are discussed in Topic paper 4: Cost of capital issues.

## Existing cost of capital IM decision CC17

<b>Decision CC17</b> <b>Cost of equity in WACC estimates – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Cost of equity is estimated using the simplified Brennan-Lally CAPM as:</p> $\text{risk free rate} \times (1 - \text{investor tax rate}) + \text{equity beta} \times \text{TAMRP}$ <ul style="list-style-type: none"> <li>• the risk free rate is the same as for the cost of debt;</li> <li>• the equity beta for Transpower is 0.61, derived from: <ul style="list-style-type: none"> <li>○ an asset beta for Transpower of 0.34; and</li> <li>○ leverage of 44% for Transpower;</li> </ul> </li> <li>• the investor tax rate is the maximum prescribed investor tax rate under the PIE tax regime, which is 30% up until 30 September 2010 and 28% thereafter. Changes in the prescribed rate will flow through to future WACC estimates automatically; and</li> <li>• the TAMRP is 7.5% until 30 June 2011 and 7% thereafter. The TAMRP is expressed as a 5-year composite rate (to match the term of the regulatory period), hence the TAMRP estimated for the 5-year period which commences on 1 July 2010 is 7.1% and for the 5-year period which commences on 1 July 2011 is 7%.</li> </ul> <p>See sections 6.5, 6.6; H3, H7, H8, H10 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

### *How we propose changing this decision*

238. As discussed in Topic paper 4: Cost of capital issues, in respect of IM decision CC17, our draft decision is to make changes to:

238.1 the equity beta estimate – we propose changing this from 0.61 to 0.58;

238.2 the leverage estimate – we propose changing this from 44% to 41%; and

238.3 our approach for calculating the asset beta – we propose updating the comparator sample and then estimating an average asset beta looking at 4-weekly (rather than the current monthly) and weekly estimates over the two most recent 5-year periods.

239. We propose that the asset beta estimate would remain at 0.34.

240. We propose that the TAMRP would remain at 7%.

241. The reasons for our draft decision in respect of IM decision CC17 are provided in Topic paper 4: Cost of capital issues.

#### Existing cost of capital IM decision CC19

<b>Decision CC19</b> <b>Cost of capital defined as estimate of WACC – Airports</b>	<p><b>Original 2010 decision</b></p> <p>The cost of capital is an estimate of firms' WACC which reflects the cost of debt and the cost of equity used to fund investment.</p> <p>In the case of airports, for ID, the Commission considers it appropriate to take a range between the 25<sup>th</sup> to 75<sup>th</sup> percentiles. In assessing profitability for the airports an appropriate starting point for any assessment is the 50<sup>th</sup> percentile (mid-point) on the range.</p> <p>See section 6.1, E1, E2 and E11 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

#### *How we propose changing this decision*

242. As discussed in Topic paper 6: WACC percentile for airports, our draft decision is to make a change in respect of IM decision CC19.
243. The proposed change is to remove the specific percentile range. Therefore we would no longer publish the 25<sup>th</sup> and 75<sup>th</sup> percentiles, and would instead publish the 50<sup>th</sup> percentile, together with a standard error of the WACC estimate so that any required percentile could be calculated.
244. The reasons for this proposed change are discussed in Topic paper 6: WACC percentile for airports.

#### Existing cost of capital IM decision CC20

<b>Decision CC20</b> <b>Commission to publish annual WACC estimates – Airports</b>	<p><b>Original 2010 decision</b></p> <p>The Commission will publish annually for airports:</p> <ul style="list-style-type: none"> <li>• a mid-point estimate of the 5-year post-tax WACC and vanilla WACC; and</li> <li>• a 25<sup>th</sup> percentile 75<sup>th</sup> percentile estimate of the 5-year post-tax WACC and vanilla WACC.</li> </ul> <p>See section 6.7, E14 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

### How we propose changing this decision

245. As discussed in Topic paper 4: Cost of capital issues, our draft decision is to make a change in respect of IM decision CC20.
246. We propose to no longer publish a 25<sup>th</sup> and 75<sup>th</sup> WACC percentile estimate. The proposed change is to calculate additional mid-point WACC estimates, along with standard errors, for the quarters that do not align with WACC estimates calculated for ID, and to publish these additional estimates either when requested by an Airport, or prior to an Airport's price setting event.
247. The reasons for this proposed change are discussed in Topic paper 4: Cost of capital issues.

### Existing cost of capital IM decision CC22

<p><b>Decision CC22</b> <b>Cost of debt in WACC estimates – Airports</b></p>	<p><b>Original 2010 decision</b></p> <p>For all regulated suppliers of airport services, the cost of debt is estimated as:</p> <p style="text-align: center;"><i>risk free rate + debt premium + debt issuance costs</i></p> <ul style="list-style-type: none"> <li>• the risk free rate is estimated by the Commission as part of publishing annual WACCs for all regulated suppliers. The risk free rate is estimated from the observed market yield to maturity of benchmark vanilla New Zealand Government NZ\$ denominated nominal bonds with a term to maturity that matches the typical term of airports' pricing agreements (5 years);</li> <li>• the debt premium is also estimated by the Commission as part of publishing annual WACCs for all regulated suppliers as the difference between the risk free rate and the yield on publicly treated corporate bonds for airports with an S&amp;P long-term credit rating of A- and a term to maturity which matches the pricing period (typically 5 years); and</li> <li>• debt issuance costs are 35 basis points (0.35%) p.a.</li> </ul> <p>See sections 6.3, E2, E4, E5, E14 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Airports</p>

*How we propose changing this decision*

248. As discussed in Topic paper 4: Cost of capital issues, in respect of IM decision CC22, our draft decision is to make implementation changes to:
- 248.1 the risk-free rate – we propose to continue using the prevailing risk-free rate, but to use 3 months of data instead of 1 month;
  - 248.2 the debt premium – we propose modifying the current implementation:
    - 248.2.1 to use 3 months of data instead of 1 month;
    - 248.2.2 to remove the government ownership limitation; and
    - 248.2.3 to reference the NSS curve as something we will consider when estimating the debt premium;
  - 248.3 issuance costs – we propose changing this from 35 basis points (0.35%) p.a. to 20 basis points (0.20%) p.a.; and
  - 248.4 swap costs – we propose including an allowance for swap costs, which is included in the above value of debt issuance costs.
249. We do not propose changing the credit rating.
250. The reasons for our draft decision in respect of IM decision CC22 are provided in Topic paper 4: Cost of capital issues.

**Existing cost of capital IM decision CC23**

<b>Decision CC23</b> <b>Term credit spread differential allowance may apply – Airports</b>	<p><b>Original 2010 decision</b></p> <p>The Airports ID Determination allows qualifying suppliers to disclose a separate allowance for the TCSD, which reflects the additional costs associated with holding a longer-term debt portfolio. The TCSD is used to adjust cash flows in ID regulation. Qualifying suppliers are suppliers with a debt portfolio which has a weighted average original tenor debt portfolio which exceeds the pricing period (typically 5 years).</p> <p>See sections 6.1, 6.3, E6 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

### *How we propose changing this decision*

251. In respect of IM decision CC23, our draft decision is to remove the TCSD allowance.
252. The reasons for our draft decision in respect of IM decision CC23 are provided in Topic paper 4: Cost of capital issues.
253. Because the TCSD allowance is currently given effect through the Airports ID determination in the defined term ‘allowance for long term credit spread’ (rather than in the Airports IMs), we propose giving effect to this draft decision through our consideration of that determination.<sup>67</sup>

### **Existing cost of capital IM decision CC24**

<b>Decision CC24</b> <b>Cost of equity in WACC estimates – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Cost of equity is estimated using the simplified Brennan-Lally CAPM as:</p> $\text{risk free rate} \times (1 - \text{investor tax rate}) + \text{equity beta} \times \text{TAMRP}$ <ul style="list-style-type: none"> <li>• the risk free rate is the same as for the cost of debt;</li> <li>• the equity beta for airports is 0.72, derived from: <ul style="list-style-type: none"> <li>○ an asset beta for airports of 0.60; and</li> <li>○ leverage of 17%;</li> </ul> </li> <li>• the investor tax rate is the maximum prescribed investor tax rate under the PIE tax regime, which is 30% until 30 September 2010 and 28% thereafter. Changes in the prescribed rate will flow through to future WACC estimates automatically; and</li> <li>• the TAMRP is 7.5% until 30 June 2011 and 7% thereafter. The TAMRP is expressed as a 5-year composite rate (to match the term of the pricing period), hence the TAMRP estimated for the 5-year period which commences on 1 July 2010 is 7.1% and for the 5-year period which commences on 1 July 2011 is 7%.</li> </ul> <p>See sections 6.3 to 6.6, E2 to E10 of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<sup>67</sup> As explained in our Topic paper 5: Airports profitability assessment, the proposed changes to the Airports ID Determination, published alongside the IM review draft decision, are only ex-ante amendments. Amendments to ex-post disclosures will be considered as part of a separate process.

*How we propose changing this decision*

254. As discussed in Topic paper 4: Cost of capital issues, in respect of IM decision CC24, our draft decision is to make changes to:
- 254.1 the leverage estimate – we propose changing this from 17% to 19%;
  - 254.2 the asset beta estimate – we propose changing this from 0.6 to 0.58; and
  - 254.3 our approach for calculating the asset beta – we propose updating the comparator sample and then estimating an average asset beta looking at 4-weekly (rather than monthly) and weekly estimates over the two most recent 5-year periods.
255. We propose that the equity beta estimate would remain at 0.72.<sup>68</sup>
256. We propose that the TAMRP would remain at 7%.
257. The reasons for our draft decision in respect of IM decision CC24 are provided in Topic paper 4: Cost of capital issues.

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<sup>68</sup> Despite the proposed changes to the leverage and the asset beta estimates, our proposed equity beta estimate remains at 0.72.

## Chapter 8: Specification of price decisions we propose changing

### Existing specification of price IM decision SP01

<b>Decision SP01</b> <b>Weighted average price cap applies – EDBs and GDBs</b>	<b>Original 2010 decision</b> Price for EDBs and GDBs is specified by a weighted average price cap.  See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB

#### *How we propose changing this decision*

258. As discussed in Topic paper 1: Form of control and RAB indexation, our draft decision in respect of IM decision SP01 is to:

258.1 change the form of control for EDBs to a revenue cap, including a wash-up for over and under-recovery of revenue; and

258.2 maintain the current weighted average price cap for GDBs, with an implementation change in the GDB IM Determination to adopt the pass-through balance approach adopted for EDBs at the last DPP reset in respect of forecast disparities in pass-through costs and recoverable costs.

259. Because we propose moving EDBs to a revenue cap, we propose that existing IM decision SP01 no longer apply to EDBs. Instead, we further discuss our proposed changes to the form of control for EDBs under existing IM decision SP02 below.

#### *Why we propose making this change for GDBs*

260. The reasons for our proposal to adopt a ‘pass-through balance’ approach for GDBs are described in Topic paper 1: Form of control and RAB indexation. This change is also noted below under IM decision SP06 for GDB recoverable costs (see below). Although it does not of itself give rise to any new category of recoverable costs, it impacts the way in which recoverable costs are applied in setting prices.

261. If these changes are confirmed, the GDB DPP determination would include provisions relating to demonstrating the recovery of pass-through costs and recoverable costs.

## Existing specification of price IM decision SP02

<b>Decision SP02</b> <b>Weighted average price cap or total revenue cap applies – GTBs</b>	<b>Original 2010 decision</b> Price for GTBs will be specified by either a weighted average price cap or a total revenue cap.  See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	GTBs

### *How we propose changing this decision*

262. As discussed in Topic paper 1: Form of control and RAB indexation, our draft decision is to change IM decision SP02 to remove the option within the IMs for a weighted average price cap or a lagged revenue cap for GTBs, instead specifying that the form of control for GTBs will be a ‘pure’ revenue cap with a revenue wash-up.
263. As also discussed in Topic paper 1: Form of control and RAB indexation, we propose that a ‘pure’ revenue cap would also apply to EDBs.
264. Due to the similarities in these proposals for GTBs and EDBs, and as noted in IM decision SP01 above, we have addressed the form of control for EDBs under this IM decision SP02.

### *Key implementation features*

265. The common key implementation features of our draft decision to apply a revenue cap to EDBs and GTBs are:
- 265.1 A cap on maximum revenues that may be recovered in each disclosure year would be specified in the DPP or CPP determination.
- 265.2 The revenue cap would compare the forecast revenues planned to be used by the GTB or EDB in setting its prices with a maximum revenue amount to be specified by the Commission. This means that the point of compliance with the revenue cap would be at the time the GTB or EDB sets its prices.
- 265.3 In addition to the revenue cap noted above, we propose also allowing for a cap on the forecast average price increase in each year’s price setting, if determined in the relevant DPP or CPP determination.
- 265.4 A revenue wash-up mechanism would apply for each year to wash-up the difference between actual revenue and actual allowable revenue values (ie, any over- or under-recovery of revenue), potentially subject to a cap on the wash-up amount which would be specified in the DPP or CPP determination.

- 265.5 Any wash-up amounts calculated would be carried forward in a wash-up account and would be applied to prices in the next applicable year. Interest at the 67<sup>th</sup> percentile post-tax WACC rate would apply to any balances carried forward in the account.
- 265.6 Any amounts drawn down from the wash-up account in accordance with rules to be set out in the DPP or CPP determination would be treated as a recoverable cost when setting prices (see IM decisions SP05 for EDBs and SP07 for GTBs).
266. A more detailed description and the reasons for these and other features of the revenue cap are described in Topic paper 1: Form of control and RAB indexation. On 28 June 2016, we anticipate publishing a paper as part of the gas DPP reset process that will discuss the implementation details on how our draft decision on the form of control for GTBs would, if confirmed, take effect at the next Gas DPP reset.
267. The practical application of these common IM features can be seen in the ‘Specification of price’ subpart of Part 3 of the respective EDB and GTB draft amended IM determinations that we have published for consultation with this report.

*We propose consequential implementation changes*

268. We propose making the following consequential implementation changes for this IM decision:
- 268.1 Because our draft decision is to move away from allowing the option of a lagged quantity revenue cap for GTBs, the revenue-setting formula in the GTB CPP IMs would need to be adjusted to remove references to the  $\Delta Q$  factor.<sup>69</sup>
- 268.2 There would be consequential drafting amendments to the GTB and EDB IM Determinations to implement our draft decision to specify revenue caps. These would include, for example, removal of the specification of the forecast weighted average growth in quantities and how this information must be presented and verified in a CPP proposal and, in the case of EDBs, the removal of the ‘pass-through balance’ approach (because this approach would effectively be applied in a similar way through the revenue wash-up mechanism).

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<sup>69</sup> Commerce Commission “Input methodologies review draft decisions: Topic paper 2 – CPP requirements” (16 June 2016), Attachment B, IM decision CP28.

### Existing specification of price IM decision SP03

<p><b>Decision SP03</b> <b>Pass-through costs – EDBs and GDBs</b></p>	<p><b>Original 2010 decision</b></p> <p>The IMs include a list of pass-through costs and a process for adding new pass-through costs.</p> <p>Pass-through costs includes local authority rates and regulatory levies.</p> <p>See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision – EDBs only</b></p> <p>This amendment applies to the IMs that apply for the specification of price for both DPPs and CPPs, and took effect from 1 April 2015, which corresponded with the start of the next DPP regulatory period.</p> <p>This amendment limits the risk of under- or over-recovery of pass-through and recoverable costs arising from uncertainty associated with forecasting.</p> <p>The amendment achieves this by limiting the calculation of allowable notional revenue and notional revenue for the weighted average price cap to ‘distribution prices’, which is defined as excluding pass-through and recoverable costs.</p> <p>The DPP determination includes provisions relating to demonstrating the recovery of pass-through and recoverable costs.</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB</p>

*How we propose changing this decision*

269. As discussed in Topic paper 2: CPP requirements, our draft decision is to change IM decision SP03 to extend the range of pass-through costs.
270. We propose changing IM decision SP03 to widen the criteria-based pass-through costs.<sup>70</sup> This is explained in Topic paper 2: CPP requirements. We propose making two changes:
- 270.1 allow criteria based pass-through costs to be specified in a s 52P determination at the time the DPP or CPP is set, as well as during the regulatory period; and
- 270.2 provide for adding any type of cost, which meets the pass-through cost criteria in the IMs, to potentially be specified as a pass-through cost in a DPP determination, rather than just levies.
271. This change would apply to EDBs and GDBs under this IM decision SP03 and to GTBs under IM decision SP04 (see below).

*Pass-through balance approach*

272. In IM decision SP01 we described our proposal to adopt for GDBs the pass-through balance approach as adopted in 2014 for EDBs in respect of differences between forecast and actual pass-through costs and recoverable costs. That proposed change would improve the way in which this decision is applied for GDBs. The implementation of our proposed changes to IM decision SP01 would result in drafting changes to the GDB IM Determination.

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<sup>70</sup> The current IMs provide the opportunity for us to specify new pass-through costs during a regulatory period in circumstances where a levy or other cost meets the criteria for a pass-through cost, set out in the IMs (criteria-based pass-through costs). In essence, these provisions operate as reopener provisions, implicitly giving us the ability to amend a determination to add new pass-through costs. However, unlike a reopener where the quantitative changes to the path are scrutinised and made in advance, these provisions allow us to add a new pass-through cost, where the amounts concerned may be automatically passed through.

### Existing specification of price IM decision SP04

<p><b>Decision SP04</b>  <b>Pass-through costs – GTBs</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>The IMs include a list of pass-through costs and a process for adding new pass-through costs.</p> <p>Pass-through costs includes local authority rates and regulatory levies.</p> <p>See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2013 amendment to this decision</b></p> <p>We amended the IMs to make changes to provisions that will apply to the DPPs for suppliers of gas pipeline services.</p> <p>The definition of pass-through costs for gas transmission services was revised to allow the pass-through of Electricity and Gas Complaints Commission levies.</p> <p><a href="#">Amendments to input methodologies for gas distribution and transmission services: Reasons paper (26 February 2013)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>GTBs</p>

#### *How we propose changing this decision*

273. As noted above in IM decision SP03, our draft decision is to change IM decision SP04 to widen the criteria-based pass-through costs. The reasons for this proposed change are discussed in Topic paper 2: CPP requirements.

## Existing specification of price IM decision SP05

<p><b>Decision SP05</b></p> <p><b>Recoverable costs – EDBs</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Recoverable costs include costs associated with a CPP application; the net incremental carry forward amount under IRIS; claw-back applied by the Commission; transmission charges; system operator charges; new investment contract charges; and avoided transmission charges.</p> <p>See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>The amendment changes the definitions in the general provisions of the IMs, and the IMs that apply to the specification of price for both DPPs and CPPs.</p> <p>It came into effect on 1 April 2015, which corresponded with the start of the next DPP regulatory period:</p> <p>This amendment introduces a recoverable cost relating to the revenue-linked quality incentive scheme for both System Average Interruption Duration Index (<b>SAIDI</b>) and System Average Interruption Frequency Index (<b>SAIFI</b>) reliability targets under s 53M(2) of the Act.</p> <p>Individual SAIDI and SAIFI targets, associated caps and collars, and a distributor-specific incentive rate, for each disclosure year are now specified in the DPP determination. EDBs now calculate a financial reward or penalty using the formula set out in the DPP determination, and apply this as a recoverable cost, ie, either a positive or negative amount.</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p> <p><b>2014 amendment to this decision (2)</b></p> <p>The amendment changes the definitions in the general provisions of the IMs, and the IMs that apply for the specification of price for both DPPs and CPPs.</p> <p>It took effect from 1 April 2015, which corresponded with the start of the next DPP regulatory period.</p> <p>This amendment introduces a recoverable cost relating to the financial incentives to compensate EDBs for revenue foregone because of energy efficiency and demand side management initiatives that are specified in the DPP determination.</p>
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EDBs can now calculate an amount that they consider demonstrates revenue foregone because of energy efficiency and demand side management initiatives, and apply this as a recoverable cost.

This recoverable cost will require approval by the Commission. The requirement to obtain the Commission's approval for charges payable by an electricity distributor to Transpower New Zealand Limited in respect of a new investment contract has been removed. The approval process will be set out in the DPP or CPP determination for the relevant regulatory period.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

### **2014 amendment to this decision (3)**

The amendment took effect from 1 April 2015, which corresponded to the start of the next DPP regulatory period.

This amendment introduces a recoverable cost that 'washes up' for the revenue impact of capex forecast for the year (or years) prior to the resetting of prices under a DPP determination.

The amendment changes the definitions in the general provisions of the IMs, and the IMs that apply for the specification of price for both DPPs and CPPs. The objective of the wash-up is to place EDBs in approximately the same position as that in which the value of the RAB was known at the commencement of the regulatory period at the time prices were reset.

The amendment provides that EDBs must calculate a 'capex wash-up adjustment', and apportion this as a recoverable cost evenly over each disclosure year of a DPP regulatory period, other than the first year. The apportioned amounts are adjusted for the cost of debt to reflect the time value of money.

The 'capex wash-up adjustment' is specified as:

[T]he present value of the difference in the series of building block allowable revenues before tax for a default price-quality path regulatory period from adopting actual values of commissioned assets instead of the forecast commissioned assets applied by the Commission in the year (or years) preceding the regulatory period when setting prices.

Distributors must also use the actual value of depreciation for the relevant preceding year (or years) for those newly commissioned assets. Where only one year of forecast commissioned asset values is involved then actual depreciation will be nil because the IMs do not permit depreciation to be calculated for newly commissioned assets in their year of commissioning.

The present value is determined using a discount rate equal to the WACC used by the Commission in setting prices for the current DPP regulatory period.

The building blocks allowable revenue before tax for the regulatory period must be calculated using the same methodology that was applied by the Commission in setting starting prices. This includes using all of the same financial inputs for the forecast years prior to the regulatory period (with the exception of commissioned assets and depreciation).

The actual values of commissioned assets will flow through to affect the calculation of building blocks allowable revenues before tax for the regulatory period other than the return on and of capital, including forecast revaluations and most aspects of the tax regulatory allowance.

The actual values of commissioned assets and depreciation will be available from EDBs' ID values calculated under Part 2 of the IMs.

The Commission made spreadsheets available to EDBs to assist with the necessary wash-up calculations.

In most cases the 'wash-up' would be expected to apply in respect of the disclosure year immediately prior to the regulatory period for which prices are reset (eg, the 2015 disclosure year for the 2016-2020 DPP regulatory period). However, when setting future price-quality paths it is possible that more than one year of forecast capex may be relied on to effectively construct the opening regulatory asset value at the commencement of a regulatory period. The amendment caters for these multi-year situations.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

#### **2014 amendment to this decision (4)**

The amendment took effect from 1 April 2015, which corresponded to the start of the next DPP regulatory period.

This amendment introduces a recoverable cost for the 'wash-up' of transmission asset purchases that are forecast to be completed prior to a price reset, but which are not concluded.

The Commission will identify in the relevant DPP or CPP determination the present value of the amount of revenues resulting from the additional expenditure forecast to be incurred during the regulatory period relating to transmission asset purchases forecast to occur prior to the regulatory period. Affected EDBs will then know in advance the amount of the wash-up adjustment that must be made if the purchase is not completed.

The amendment provides that a 'transmission asset wash-up adjustment' must be calculated by an electricity distributor for each disclosure year of a DPP regulatory period other than the first year. The adjustment is then applied as a recoverable cost. This recoverable cost, which is a negative amount, is effectively spread equally over the regulatory period, adjusted for the cost of debt.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

**2014 amendment to this decision (5)**

This amendment took effect from 1 April 2015, which corresponded with the start of the next DPP regulatory period.

The amendment provides that a ‘transmission asset wash-up adjustment’ must be calculated by an electricity distributor for each disclosure year of a DPP regulatory period other than the first year. The adjustment is then applied as a recoverable cost. This recoverable cost, which is a negative amount, is effectively spread equally over the regulatory period, adjusted for the cost of debt.

This amendment introduces a recoverable cost to provide for the recovery of levies or other charges, revenues, or costs associated with any requirements in the Electricity Industry Participation Code 2010 relating to extended reserves that may be implemented during a regulatory period. EDBs can calculate amounts relating to extended reserves, and apply this as a recoverable cost, which can be a positive or negative amount.

This recoverable cost will require approval by the Commission. The approval process will be specified for each regulatory period in a DPP or CPP determination. The Commission’s approval of this recoverable cost will have regard to any stated policy intent by the Electricity Authority on whether:

- compensation payments to be made by a distributor would be expected to be treated as negative recoverable costs; or
- revenues to be received by a distributor would be expected to be treated as unregulated income.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

**2014 amendment to this decision (6)**

The amendment took effect from 1 April 2015, which corresponds to the start of the next DPP regulatory period.

This amendment allows for the recovery of prudent expenditure incurred in response to a catastrophic event, prior to any reconsideration of a price-quality path taking effect. The Commission will specify the amount that can be recovered as a recoverable cost by amending the relevant DPP or CPP determination issued in response to a catastrophic event.

The recoverable cost amount covers the additional net costs prudently incurred by a distributor in its response to a catastrophic event (ie, costs that are not provided for in a DPP or CPP):

- It includes unrecovered pass-through or recoverable costs, and costs related to the financial impact of a catastrophic event on a quality incentive scheme; and
- It excludes any foregone revenue due to the impact of a catastrophic event.

This amendment is substantively the same as that included in the variation to the specification of price IM agreed with Orion New Zealand for its CPP in the event of the path being reopened for another catastrophic event.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

#### **2014 amendment to this decision (7)**

This amendment applies to the IMs that apply for the specification of price for both default and CPPs, and took effect from 1 April 2015, which corresponds to the start of the next DPP regulatory period.

This amendment covers the additional net financial impact due to price path reconsideration events, other than a catastrophic event. It allows compensation for EDBs or consumers of any additional net costs associated with the impact of price path reconsideration events, where those costs are incurred prior to any reconsideration of the price-quality path taking effect.

The Commission will specify the amount that can be recovered as a recoverable cost in the relevant DPP or CPP determination issued following a price path reconsideration event. The recoverable cost can be a positive or negative amount.

This recoverable cost amount covers the additional net financial impact prudently incurred by a distributor as a result of a legislative or regulatory change event, or amounts to mitigate the effect of an error or provision of false or misleading information. It covers the period from the date of the event (for a change event) or from the start of the existing regulatory period (for an error or false information).

Amounts related to the financial impact of a price path reconsideration event on a quality incentive scheme are included, as well as any foregone revenue.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

	<p><b>2014 amendment to this decision (8)</b></p> <p>This amendment applies to the IMs that apply for the specification of price for both default and CPPs, and took effect from 1 April 2015, which corresponds to the start of the next DPP regulatory period.</p> <p>This amendment modifies the existing treatment of avoided transmission charges associated with distributed generation to allow any changes implemented in accordance with the Electricity Act 2010 to be accommodated.</p> <p>The addition of a new recoverable costs term means that we can be flexible in the event of any changes to the Electricity Authority's Electricity Industry Participation Code regarding avoided transmission charges associated with distributed generation.</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p> <p><b>2014 amendment to this decision (9)</b></p> <p>This amendment applies to the IMs that apply for the specification of price for both default and CPPs, and took effect from 1 April 2015, which corresponds to the start of the next DPP regulatory period.</p> <p>This amendment limits the risk of under- or over-recovery of pass-through and recoverable costs arising from uncertainty associated with forecasting.</p> <p>The amendment achieves this by limiting the calculation of allowable notional revenue and notional revenue for the weighted average price cap to 'distribution prices', which is defined as excluding pass-through and recoverable costs.</p> <p>The DPP determination includes provisions relating to demonstrating the recovery of pass-through and recoverable costs.</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>EDBs</p>

### *How we propose changing this decision*

274. In respect of IM decision SP05, we propose adding two new recoverable costs:

- 274.1 as discussed in Topic paper 1: Form of control and RAB indexation, we propose introducing a recoverable cost for the draw-down of the revenue cap wash-up balance; and
- 274.2 as discussed in Topic paper 2: CPP requirements, we propose introducing a new recoverable cost allowance to allow suppliers to recover prudently incurred expenditure in response to an urgent project ('urgent project allowance').

Draw down of revenue cap wash-up balance

275. A new class of recoverable cost would arise from our proposed change to apply a revenue wash-up mechanism to GTBs and EDBs (see IM decision SP02).
276. The key implementation features of the proposed revenue wash-up mechanism and the resulting requirements for recognition of the recoverable cost in revenue would be for an EDB to:
- 276.1 carry out the revenue wash-up calculation for each year (as described in IM decision SP02);
- 276.2 maintain a wash-up account to record wash-up amounts and changes to the balance (positive or negative);
- 276.3 record draw-down amounts in the wash-up account that would be applied in the calculation of revenue and prices in a later year; and
- 276.4 record in the wash-up account the time value of money calculated at the DPP 67<sup>th</sup> percentile post-tax WACC rate on the balance in the wash-up account.
277. We propose that the common base rules for EDBs and GTBs operating the wash-ups and making draw-downs from the wash-up account would be:
- 277.1 The wash-up account would record differences between the actual revenue and actual allowable revenue values for the pricing year, whether positive or negative.
- 277.2 The calculation of the net allowable revenue (ie, essentially a trued up revenue cap at the time of the revenue wash-up) would use the same X factor as used when setting the forecast net allowable revenue at the time prices are set.
- 277.3 The calculation of both forecast and actual values would include the relevant values for pass-through costs and recoverable costs, so that these would effectively get washed up in the calculations.
- 277.4 The calculation of actual revenue for the wash-up would use the same prices as used at the time prices are set for the purpose of testing compliance with the revenue cap.
- 277.5 The total revenues used for the revenue wash-up would be based on actual quantities supplied, and would include the sum of other regulated income and, in the case of GTBs, would include the proceeds of capacity auctions.
- 277.6 A forecast CPI and an X factor would be used to set the price path for the regulatory period. At the time of the wash-up the actual allowable revenue would be adjusted to reflect a price path based on the actual CPI and the same X factor.

- 277.7 The resulting wash-up amount may be capped at a level that would be specified by the Commission in a s 52P determination (ie, a wash-up cap).
- 277.8 The draw-down amount from the wash-up account that may later be applied to prices as a recoverable cost (or negative recoverable cost if that is the case) may be specified as taking into account a cap and a collar and would in that case be specified by the Commission in a s 52P determination (ie, a draw-down cap and collar).
- 277.9 The balance in the wash-up account would roll forward from year to year (or between regulatory periods where applicable), taking into account wash-up entries, draw-down amounts, and the time value of money calculated on the balance in the account.
278. In addition to the common features for EDBs and GTBs, we propose the following would apply to EDBs only:
- 278.1 If specified by the Commission in an EDB DPP or CPP determination, a limit may apply to the amount that an EDB may recover in the revenue wash-up process when the EDB has intentionally and voluntarily undercharged its revenues relative to the amount allowed in the DPP or CPP.
- 278.2 For any undercharging to be intentional and voluntary, the amount of the relevant undercharge and any limit on its recovery must be known to an EDB when it is setting its prices.
- 278.3 The relevant undercharge amount will be the forecast allowable revenue less the forecast revenue. These forecast amounts would be used instead of actual amounts, as it is only the forecast amounts that will be available to EDBs when setting prices.
- 278.4 A limit on the recovery of this undercharge amount would be a fixed percentage of the forecast allowable revenue. The value of the percentage would be specified in a DPP or CPP determination. If an EDB were to undercharge to an extent greater than the limit, then this would give rise to a 'voluntary undercharging deduction amount', where this amount would be the relevant undercharge less the limit. This voluntary undercharging deduction amount would be subtracted from the wash-up balance.
- 278.5 The purpose of this mechanism is to limit the accumulation of a large credit balance in the wash-up account from intentional undercharging by an EDB. Details of this mechanism would be set out in an EDB DPP or CPP determination.
- 278.6 Any accumulated balance of undercharging deduction amounts would be a factor in the future calculations of draw down amounts from the wash-up account, as specified by the Commission in a DPP or CPP determination. Undercharging amounts would be rolled forward in the wash-up account if the EDB does not draw them down into revenues.

- 278.7 This process of accumulating undercharging deduction amounts will arise as a routine part of the wash-up account. The forecast allowable revenue available to EDBs when setting prices will include the wash-up balance that is available to be drawn down.
- 278.8 Because EDBs are currently subject to the ‘pass-through balance’ approach, it is possible that an EDB would have unrecovered pass-through costs or recoverable costs relating to the period prior to the revenue cap and wash-up mechanism going into effect. We therefore propose that an EDB would be able to calculate an opening balance for its wash-up account on a transition basis.
279. Further description, and the reasons for these and other features of the revenue wash-up mechanism, is contained in Topic paper 1: Form of control and RAB indexation. A description of the implementation as it would, if confirmed, apply to GTBs at the next Gas DPP reset (and key aspects which would also apply to EDBs at the later EDB DPP reset or to an EDB CPP after implementation) will be described in the Gas DPP implementation paper, which we anticipate publishing on 28 June 2016.
280. The practical implementation of these proposed features can also be seen in the ‘Specification of price’ subpart of Part 3 of the respective EDB and GTB draft amended IM determinations that we have published for consultation with this report.

#### Urgent project allowance

281. As discussed in Topic paper 2: CPP requirements, we propose introducing a new recoverable cost allowance to allow suppliers to recover prudently incurred expenditure in response to an urgent project. This draft decision also applies to GDBs (IM decision SP06) and GTBs (IM decision SP07). Our reasons for this proposed change are discussed in Topic paper 2: CPP requirements.

#### Energy efficiency and demand-side management incentive allowance

282. Implementing a revenue cap for EDBs would mean that there would no longer be a need to provide an energy efficiency and demand-side management incentive allowance, as EDBs would no longer face lower revenues if the volume of energy used by their consumers decreases.

#### Review of recoverable costs

283. We also propose that the words “non-exempt” be removed from clause 3.1.3(1)(b) of the EDB IM Determination. This is to ensure comparability of the measurement of the return on investment for ID purposes between exempt and non-exempt EDBs.

## Existing specification of price IM decision SP06

<b>Decision SP06</b> <b>Recoverable costs – GDBs</b>  <b>(original 2010 decision amended)</b>	<p><b>Original 2010 decision</b></p> <p>Recoverable costs include costs associated with a CPP application; the net incremental carry forward amount under IRIS; and claw-back applied by the Commission.</p> <p>See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2013 amendment to this decision</b></p> <p>Amended the IMs to make changes to provisions that will apply to the DPPs for suppliers of gas pipeline services.</p> <p>The definition of recoverable costs was amended to refer to the recovery of balancing gas costs or credits from welded parties, as well as shippers, on a supplier’s network. Welded parties are defined as those entities having an interconnection agreement with the GTB.</p> <p><a href="#">Amendments to input methodologies for gas distribution and transmission services: Reasons paper (26 February 2013)</a></p>
<b>This original decision applies to (sector):</b>	GDBs

### *How we propose changing this decision*

284. In respect of IM decision SP06, we propose adding three new recoverable costs for GDBs:
- 284.1 we propose a 'wash-up' of forecast capex for the year (or years) prior to the setting of a DPP, consistent with our 2014 decision for EDBs and consistent with GTBs;<sup>71</sup>
- 284.2 we propose allowing for the recovery of prudent expenditure incurred in response to a catastrophic event, consistent with our 2014 decision for EDBs and consistent with GTBs;<sup>72</sup> and

<sup>71</sup> Commerce Commission “Input methodology amendments for electricity distribution services: Default price-quality paths” (27 November 2014).

<sup>72</sup> Commerce Commission “Input methodology amendments for electricity distribution services: Default price-quality paths” (27 November 2014).

284.3 as discussed in Topic paper 2: CPP requirements, we propose introducing a new recoverable cost allowance to allow suppliers to recover prudently incurred expenditure in response to an urgent project ('urgent project allowance').

285. We also propose adopting a wash-up approach for the treatment of pass-through costs and recoverable costs.

*Why we propose making these changes*

'Wash-up' of forecast capex

286. We made this amendment for EDBs in November 2014.<sup>73</sup> We are now proposing this change for GDBs to align with the treatment for EDBs.

287. This proposed recoverable cost would 'wash-up' for the revenue impact of capex that is forecast for the year (or years) prior to the resetting of prices under a DPP determination. The objective of the wash-up would be to place GDBs in approximately the same position as that in which the value of the RAB was known at the commencement of the regulatory period when prices were reset.

288. The 'capex wash-up adjustment' would be specified as the present value of the difference in the series of building block allowable revenues before tax for a DPP regulatory period from adopting actual values of commissioned assets instead of the forecast commissioned assets applied by the Commission in the year (or years) preceding the regulatory period when setting prices.

289. We propose that the building blocks allowable revenue before tax for the regulatory period would be calculated using the same methodology that was applied by the Commission in setting starting prices. This would include using all of the same financial inputs for the forecast years prior to the regulatory period (with the exception of commissioned assets and depreciation).

290. The actual values of commissioned assets and depreciation would be available from GDBs' ID values calculated under Part 2 of the IMs.

291. By setting out the method for calculating the difference between the forecast and actual return on and return of commissioned assets, GDBs would be able to calculate the adjustment themselves.

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<sup>73</sup> Commerce Commission "Input methodology amendments for electricity distribution services: Default price-quality paths" (27 November 2014), paras 7.1-7.15.

Allowing for the recovery of prudent expenditure incurred in response to a catastrophic event

292. We made this amendment for EDBs in November 2014.<sup>74</sup> We are now proposing this change for GDBs to align with the treatment for EDBs.
293. Defining the share of risks between GDBs and consumers prior to any future catastrophic event would provide greater certainty to all parties.
294. The proposed recoverable cost would help provide an appropriate level of compensation to GDBs for expenditure incurred after the event following a catastrophic event and prior to any reconsideration by us taking place.
295. We consider that in catastrophic circumstances, providing ex-post compensation for additional net costs would strengthen the existing incentives that the GDB has to restore supply. Consumers would benefit from expenditure to repair the gas distribution network because it would help ensure that demand is able to be met.
296. This recoverable cost would allow for recovery of prudent expenditure incurred in response to a catastrophic event, prior to any reconsideration of a price-quality path taking effect. We would specify the amount that can be recovered as a recoverable cost by amending the DPP determination or by including the amount in any CPP determination issued in response to the catastrophic event.
297. The recoverable cost amount would cover the additional net costs prudently incurred by a GDB in its response to a catastrophic event (ie, costs that are not already provided for in a DPP or CPP. However, no additional compensation (either ex ante or ex-post) would be provided for lower-than-forecast revenues due to future catastrophic events.

Urgent project allowance

298. As discussed in Topic paper 2: CPP requirements, we propose introducing a new recoverable cost allowance to allow suppliers to recover prudently incurred expenditure in response to an urgent project. This draft decision also applies to GTBs (IM decision SP07) and EDBs (IM decision SP05). Our reasons for this proposed change are discussed in Topic paper 2: CPP requirements.

Pass-through balance approach

299. In IM decision SP01 we described our proposal to adopt a pass-through balance approach (as recently adopted for EDBs) in respect of differences between forecast and actual pass-through costs and recoverable costs. That draft decision would improve the way in which decisions under this IM decision SP06 are applied. The implementation of that draft decision would result in drafting changes to the GDB IM Determination.

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<sup>74</sup> Commerce Commission “Input methodology amendments for electricity distribution services: Default price-quality paths” (27 November 2014), paras 11.1-11.30.

### Energy efficiency and demand-side management incentive allowance

300. Implementing a revenue cap for EDBs would mean that there would no longer be a need to provide an energy efficiency and demand-side management incentive allowance, as EDBs would no longer face lower revenues if the volume of energy used by their consumers decreases.

### **Existing specification of price IM decision SP07**

<b>Decision SP07</b> <b>Recoverable costs – GTBs</b>	<b>Original 2010 decision</b> Recoverable costs include costs associated with a CPP application; the net incremental carry forward amount under IRIS; claw-back applied by the Commission; and costs or credits associated with the sale or purchase of balancing gas.  See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	GTBs

### *How we propose changing this decision*

301. In respect of IM decision SP07, we propose adding five new recoverable costs:

- 301.1 as discussed in Topic paper 1: Form of control and RAB indexation, we propose introducing a recoverable cost for the draw-down of the revenue cap wash-up balance;
- 301.2 we propose a 'wash-up' of forecast capex for the year (or years) prior to the setting of a DPP determination, consistent with our 2014 decision for EDBs and consistent with GDBs;
- 301.3 we propose allowing for the recovery of prudent expenditure incurred in response to a catastrophic event, consistent with our 2014 decision for EDBs and consistent with GDBs;
- 301.4 we propose including a recoverable cost for compressor fuel gas; and
- 301.5 as discussed in Topic paper 2: CPP requirements, we propose introducing a new recoverable cost allowance to allow suppliers to recover prudently incurred expenditure in response to an urgent project ('urgent project allowance').

302. We also propose a change that would clarify the treatment of balancing gas as a recoverable cost.
303. Finally, this section discusses MDL's proposed extension to the recoverable costs, which we do not propose to implement.<sup>75</sup>

*Why we propose making these changes*

Draw down of revenue cap wash-up balance

304. A new class of recoverable cost would arise from our draft decision to apply a revenue wash-up mechanism to GTBs (and EDBs). The common key implementation features of the proposed wash-up mechanism and the resulting requirements for recognition of the recoverable cost in revenue are described in detail for EDBs in IM decision SP05 above.
305. Further description and the reasons for this proposed change are described in Topic paper 1: Form of control and RAB indexation. A description of the implementation as it would, if confirmed, apply to GTBs at the next Gas DPP reset will be described in the Gas DPP implementation paper, which we anticipate publishing on 28 June 2016.
306. The practical application of this draft decision can also be seen in the 'Specification of price' subpart of Part 3 of the draft amended GTB IM determination that we have published for consultation alongside this report.

'Wash-up' of forecast capex

307. This change is proposed to align the proposed treatment of GTBs with GDBs (see our reasons in more detail under IM decision SP06 above). We made this amendment for EDBs in November 2014.

Allowing for the recovery of prudent expenditure incurred in response to a catastrophic event

308. This change is proposed to align the proposed treatment of GTBs with GDBs (see our reasons in more detail under IM decision SP06 above). We made this amendment for EDBs in November 2014.
309. This recoverable cost would allow for recovery of prudent net additional expenditure incurred by a GTB in response to a catastrophic event (ie, costs that are not already provided for in a DPP or CPP price path), prior to any reconsideration of a price-quality path taking effect.

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<sup>75</sup> MDL, Untitled submission on problem definition paper (21 August 2015), pp. 3-4.

310. We would specify the amount of the recoverable cost by amending the DPP determination or include the amount in any CPP determination issued in response to the catastrophic event. Although no additional compensation for lower-than-forecast revenues due to catastrophic events would be provided for through this recoverable cost, such compensation would effectively be provided for GTBs through the proposed revenue cap and revenue wash-up mechanism, subject to any cap on the wash-up amount if specified in the DPP or CPP determination.

Compressor fuel gas a recoverable cost in some instances

311. This proposed amendment to the IMs would allow a GTB to select the least cost option when choosing to balance its pipeline, and for consumers and the Commission to be satisfied this is the correct choice.
312. A consequential change to the GTB annual compliance statement is proposed, requiring the directors of the GTB sign off through the general certification of the compliance requirements that the lower cost option was selected in all instances of compressor use for balancing operations.
313. The proposed change is in response to an issue raised by MDL in its submission. MDL proposed that the definition of recoverable cost is expanded to include a new recoverable cost item for compressor fuel gas costs.<sup>76</sup>
314. We consider that the proposed change would allow flexibility for GTBs and would result in lower costs for consumers without adversely affecting the quality of supply or the GTB's compliance costs. It combines an incentive to select the lowest cost for consumers and a requirement to provide information that is reasonably necessary to demonstrate this has been done by the GTB.
315. However, we consider this should be limited to cases where, in any event of compressor use, the compressor fuel gas cost is less than a balancing gas transaction that has the same effect on the system as the compressor use.

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<sup>76</sup> MDL, Untitled submission on problem definition paper (21 August 2015), pp. 4-6.

316. We are particularly interested in submissions from stakeholders on:
- 316.1 whether director certification is a sufficient demonstration of compliance with the 'lowest cost' balancing policy;
  - 316.2 whether a business policy-based approach, backed up by only enough information reasonably necessary to demonstrate the application of that policy, would provide sufficient transparency for stakeholders;<sup>77</sup> and
  - 316.3 the provision in the current GTB IM Determination<sup>78</sup> that requires Commission approval for amounts of balancing gas transactions, as specified in a DPP determination. We have not proposed any change in this implementation aspect, but we are aware that proposed changes to the Maui Pipeline Operating Code may mean an increase in the number of transactions. We do not wish the IMs to present a barrier to commercial transactions under the operating code and seek the views of stakeholders on this proposed approach.

#### Urgent project allowance

317. As discussed in Topic paper 2: CPP requirements, we propose introducing a new recoverable cost allowance to allow suppliers to recover prudently incurred expenditure in response to an urgent project. This draft decision also applies to GDBs (IM decision SP06) and EDBs (IM decision SP05). Our reasons for this proposed change are discussed in Topic paper 2: CPP requirements.

#### Proposed change to clarify treatment of balancing gas as a recoverable cost

318. In May 2015, we provided clarification to the GTBs and industry on the treatment of balancing gas as a recoverable cost. This was via a letter sent to the parties and published on our website.<sup>79</sup> The relevant text is:

We consider that recoverable costs include: cash-outs under the current gas balancing regime; and daily cash-outs arising from the regime pursuant to MDL's change request.

We consider that the relevant input methodology does not limit recoverable costs to those arising in respect of the supplier's own network. As a consequence, recoverable costs will include both cash-out costs and credits for MDL, and cash-out costs and credits for Vector.

319. MDL has requested that this advice be codified in the IMs.<sup>80</sup>

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<sup>77</sup> This would be in contrast with the current prescriptive approach adopted in the current DPP, where detailed counterparty and pricing information on every transaction is required to be included in the annual compliance statement.

<sup>78</sup> *Gas Transmission Services Input Methodologies Determination 2012* [2012] NZCC 28.

<sup>79</sup> Commerce Commission, Letter to Maui Development Limited and Vector Limited "Recoverable costs in respect of gas balancing" (12 May 2015), available at: <http://www.comcom.govt.nz/dmsdocument/13232>.

<sup>80</sup> MDL, Untitled submission on problem definition paper (21 August 2015), p. 3.

320. We agree that amending the IMs to codify the clarification already provided would improve ongoing certainty.
321. The industry change that has put the different networks under common ownership is not expected to alter the conclusions in the advice provided in the letter and so does not affect the proposed IM changes:
- 321.1 a cash-out transaction would be recognised as a recoverable cost;
- 321.2 when that transaction affects another supplier's network, the other supplier may recover balancing costs relating to the other system transaction; and
- 321.3 for a consolidated supplier this should result in the balancing between systems transactions effectively cancelling out and being an internal transfer.
322. MDL also made a submission which seeks to expand the definition of recoverable costs, beyond 'cash-outs', to include all aspects of any balancing regime the GTBs have in place.<sup>81</sup>
323. However, our 2010 EDB GPB Reasons Paper states:<sup>82</sup>
- It is not appropriate for all costs associated with balancing activities to be treated as pass-through costs, as many of these functions can reasonably be expected to be performed by a GTB as part of the regulated service.
324. We therefore do not consider it appropriate to expand the definition of recoverable costs to include all balancing actions.

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<sup>81</sup> MDL, Untitled submission on problem definition paper (21 August 2015), pp. 3-4.

<sup>82</sup> Commerce Commission "Input methodologies (electricity distribution and gas pipeline services) reasons paper" (22 December 2010), J2.32.

## Chapter 9: Reconsideration of the price-quality path decisions we propose changing

### Existing reconsideration of the price-quality path IM decision RP01

<p><b>Decision RP01</b></p> <p><b>Reconsideration of DPP</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>For all services, a DPP may be reconsidered if a material error is discovered in the determination; or a supplier has provided false or misleading information, which the Commission has relied upon in making its determination.</p> <p>See section 8.4 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>High Court judgment in <i>Wellington International Airports Ltd and others v Commerce Commission</i> [2013] NZHC 3289 (11 December 2013) and Commerce Commission “Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court” (27 November 2014). See amended definitions of ‘catastrophic event’, ‘change event’ and clauses 4.5.1 to 4.5.5 of each of the EDB IM Determination, GDB IM Determination and GTB IM Determination:</p> <p>A DPP may be reconsidered if a catastrophic event or change event has occurred. This aligns the DPP reconsideration provisions with the CPP provisions.</p> <p><a href="#">Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court (27 November 2014)</a></p> <p><a href="#">Wellington International Airport Ltd &amp; Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013]</a></p>
<p><b>This original decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

*How we propose changing this decision*

325. Our draft decision is to make changes to IM decision RP01. We propose amending the DPP reconsideration provisions to:
- 325.1 expand the existing 'error' reopener provision for EDBs, GDBs and GTBs;
  - 325.2 introduce a DPP reopener that would allow us to reconsider an EDB's quality standards, in place of the current option for EDBs to apply for a quality-only CPP;
  - 325.3 introduce a new reopener provision to allow a price-quality path to change in response to a major transaction for EDBs, GDBs and GTBs; and
  - 325.4 introduce a new reopener provision to allow NCA and s 52Q workability fixes to a DPP when they result in a non-equivalent effect on the price-quality path for EDBs, GDBs and GTBs.

*Why we propose making these changes*

Expanded error reopener provision

326. We propose expanding the current error provision to address the situation where a price-quality path was set on the basis of any type of error. This could include cases where incorrect data was used in setting the DPP, or where the data was correct but was applied incorrectly.
327. At present, the error provisions are limited to dealing with incorrect data and cannot be used in situations where, for example, data was incorrectly or mistakenly applied.
328. The proposed change does not seek to incorporate any additional new information (beyond corrections) or include information that, post determination, is subsequently considered better for setting a price-quality path.

Introduction of a quality standard reopener for EDBs

329. We propose introducing a DPP reopener that would allow us to reconsider EDBs' quality standards, in place of the current option for EDBs to apply for a quality-only CPP. Our reasons for proposing this change are discussed in Topic paper 2: CPP requirements.

Major transactions reopener provision

330. We propose a new reconsideration provision to allow us to reopen a price-quality path (or paths), if necessary, to respond to a major transaction.

331. In addition to provisions in the IMs that are intended to provide certainty about the treatment of amalgamations in particular (IM decisions AM01 to AM03), there are also compliance provisions in the relevant price-quality path determinations setting out how major transactions will be addressed more generally.<sup>83</sup> In applying these provisions to ensure price-quality paths apply as intended following a major transaction, it is possible that there may need to be a change to one or more regulated suppliers' allowable revenues and/or quality standards. The proposed reconsideration provision would make it clear we may reopen the price-quality path, if necessary, to ensure the price-quality path(s) still apply as intended to the relevant regulated services.
332. This would not cover situations where the Commission or a supplier wanted to change the price-quality path for any reason other than responding to the new circumstances following a major transaction.
333. We consider that this reconsideration provision is necessary because there are many ways that transactions could occur, and it is not feasible to establish compliance provisions that can account for all situations. The major transactions reconsideration provision would allow us to amend the path where necessary to take account of these unforeseen situations.
334. In establishing this provision, we propose to include a definition of major transactions in the IM determinations based on the existing definition in relevant DPP determinations and on the definition provided in s 129 of the Companies Act 1993.
335. The reconsideration provision would then have the following features:
- 335.1 be triggered by the Commission;
  - 335.2 only apply to the price-quality path to the extent necessary to respond to the major transaction; and
  - 335.3 allow for the Commission to undertake any consultation it considers appropriate in each circumstance.

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<sup>83</sup> For example, *Electricity Distribution Services Default Price-Quality Path Determination 2015* [2014] NZCC 33, clause 10.

Reconsideration to apply the NCA and s 52Q where they result in a non-equivalent effect

336. This reconsideration provision would allow us to implement workability fixes, when they result in a non-equivalent effect on a price-quality path.<sup>84</sup> There would be two triggers for this provision:
- 336.1 when the application of the proposed NCA approach in the IMs (explained in our proposed IM decision GE01 above) results in a non-equivalent effect on allowable revenues; or
- 336.2 when a provision in a price-quality determination becomes unworkable, and the NCA approach results in a change to the price-quality path.
337. We expect that most workability problems can be resolved without this reopener. The proposed NCA approach would allow us to resolve most workability problems with the IMs, and without affecting a price-quality path. Further, many workability problems with a price-quality determination will only require an amendment under s 52Q, and will not affect the price-quality path.
338. Furthermore, no reconsideration of any price-quality path would need to occur where the alternative approach relates to a price-quality path where the prescriptive method becomes unworkable after having already been applied in setting that path.
339. However, in rare circumstances it might not be possible to develop an alternative approach that does not require a reconsideration of a current price-quality path. We are therefore proposing the reconsideration provision to allow us to apply workability fixes when the NCA approach involves a reconsideration of the price-quality path, such as when the change has a non-equivalent effect on the calculation of pass-through or recoverable costs.
340. The proposed reconsideration provision would:
- 340.1 be triggered by the Commission when it considers that an alternative approach developed under s 52Q or the NCA results in a non-equivalent effect on the current price-quality path;
- 340.2 have no revenue materiality threshold;
- 340.3 only apply to the price-quality path to the extent necessary to give effect to the application of the NCA approach; and
- 340.4 allow for the Commission to undertake any consultation it considers appropriate in each circumstance.

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<sup>84</sup> Price is defined in s 52C as able to be specified in the form of numbers or formulas. Therefore, a non-equivalent effect on a price path could potentially arise from either a change in price, or a change in the formula for determining price.

## Existing reconsideration of the price-quality path IM decision RP02

<b>Decision RP02</b> <b>Reconsideration of CPP</b>	<p><b>Original 2010 decision</b></p> <p>For all services, a CPP may be reconsidered if one of the following events has occurred:</p> <ul style="list-style-type: none"> <li>• a catastrophic event, for which the costs of rectifying the impact of the event is material; or</li> <li>• a material error is discovered in the determination; or</li> <li>• a supplier has provided false or misleading information, which the Commission has relied upon in making its determination; or</li> <li>• a change in legislative or regulatory requirements that has a material impact on costs</li> </ul> <p>See section 8.4 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

### *How we propose changing this decision*

341. Our draft decision is to make a change to IM decision RP02.
342. We propose amending the CPP reconsideration provisions to:
- 342.1 provide for reconsideration of a CPP where there is a DPP WACC change. This proposed decision links with our decision to use the prevailing DPP WACC rate throughout a CPP (see IM decision CC03);
  - 342.2 expand the scope of the existing ‘error’ reopener provision;
  - 342.3 introduce a new reopener provision to allow a CPP to change in response to a major transaction for EDBs, GDBs and GTBs; and
  - 342.4 introduce a new reopener provision to allow NCA and s 52Q workability fixes to a CPP when they result in a non-equivalent effect on the price-quality path for EDBs, GDBs and GTBs.

### *Why we propose making these changes*

#### Re-opening the CPP price path to apply an updated DPP WACC rate

343. Our reasons for proposing this change are discussed in Topic Paper 4: Cost of capital issues.

Expanded error reopener provision

344. We propose making this change to IM decision RP02 for the same reasons as above for IM decision RP01.

Major transactions reopener provision

345. We propose making this change to IM decision RP02 for the same reasons as above for IM decision RP01.

Reconsideration to apply workability fixes

346. We propose making this change to IM decision RP02 for the same reasons as above for IM decision RP01.

**Existing Reconsideration of the price-quality path IM decision RP03**

<p><b>Decision RP03</b>  <b>Meaning of ‘material’ for purposes of reconsideration</b></p>	<p><b>Original 2010 decision</b></p> <p>In this context, material means that the impact of the event over the remainder of the regulatory period is at least 1% of the aggregated allowable notional revenue for the years in which the costs associated with the event are incurred.</p> <p>See section 8.4 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

*Why we propose changing this decision*

347. We propose amending IM decision RP03 to change the 1% materiality threshold on allowable revenue so that the error reopener would only apply to errors in allowable revenue, rather than errors that might affect other aspects of the price-quality path. This would exclude all other aspects of the price-quality path, for example, quality standards.

348. We have not seen any evidence to suggest any further changes are required to the materiality threshold.

**Existing reconsideration of the price-quality path IM decision RP04**

<p><b>Decision RP04</b>  <b>Reconsideration for contingent or unforeseen expenditure under a CPP – GTBs</b></p>	<p><b>Original 2010 decision</b></p> <p>A GTB’s CPP may also be reconsidered if a trigger event occurs for a project on the contingent project list, or an unforeseen project has commenced or is committed to take place during a CPP regulatory period.</p>
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The Commission has incorporated additional mechanisms for dealing with contingent or unforeseen gas transmission investments by adopting a contingent/unforeseen project approach, whereby:

- the costs of particular large investments are not provided for in the *ex ante* revenue allowance where the need, timing, and/or costs of the project are uncertain or the project is unforeseen when a proposal is submitted;
- the Commission will only reconsider the price path if the GTB satisfies the Commission that the project will proceed; and
- the amendment to the price path will not take effect until the year in which assets associated with the project are forecast to be commissioned.

Contingent projects are tied to a specific trigger event and forecast costs must meet a materiality threshold. A trigger event is a condition or event that (among other things) is not within the control of the GTB and would reasonably cause the GTB to undertake the project.

The GTB must demonstrate that the assets associated with the project are likely to be commissioned during the CPP regulatory period.

The forecast or indicative capex of the project must be at least 10 per cent of the value of the applicant's most recently disclosed annual revenue. This is equivalent to an increase of approximately one per cent per annum of the annual allowable revenue and is consistent with the materiality threshold that forms part of the cost allocation IM.

Proposals must include sufficient information to enable the Commission to identify whether a project satisfies the contingent project criteria. The independent verifier will be required to provide an opinion as to whether the project satisfies the criteria.

Projects approved as contingent projects (and the trigger events for each project) will be identified in a CPP determination. The Commission may also decide to classify other projects (than those proposed by the supplier) as contingent projects.

The Commission considers that it is appropriate to accommodate 'unforeseen projects' under the contingent project mechanism if the project satisfies the following criteria:

- it was unforeseeable to a prudent operator of gas transmission services at the time it submitted its CPP proposal; and
- it meets the same materiality threshold as a contingent project.

A GTB may apply to the Commission to reconsider the price path where a trigger event has occurred or an unforeseen project has commenced or is committed to proceed during the CPP regulatory period.

	<p>Reconsideration arising from a contingent project or unforeseen project is not an opportunity to reconsider all aspects of the original proposal. Rather it allows the Commission the opportunity to scrutinise the justification for the proposed incremental increase in forecast capex and operating expenditure (<b>opex</b>), over and above the forecast capex and opex already provided for in the MAR. Any amendment to the price path will not take effect until the year in which assets associated with the project are forecast to be commissioned.</p> <p>See sections 8.4 and 9.5 and Appendix K of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	GTBs

*How we propose changing this decision*

349. Our draft decision is to extend IM decision RP04 so that it applies to EDBs and GDBs, as well as GTBs.

*Why we propose making this change*

350. The reasons for our draft decision in respect of IM decision RP04 are described in Topic paper 2: CPP requirements.
351. Extending this reopener would allow us to reopen the price path for EDBs and GDBs (in addition to GTBs) to build in incremental expenditure for projects where the time, scope or cost was not known at the time the CPP was set. We consider that this reopener is appropriate under a CPP as we would have already scrutinised the underlying expenditure when we initially determined the CPP, without concerns that the project may be already provided for in the path.<sup>85</sup>

<sup>85</sup> Commerce Commission “Input methodologies review draft decisions: Topic paper 2 – CPP requirements” (16 June 2016), paras 109-115.

## Existing reconsideration of the price-quality path IM decision RP05

<p><b>Decision RP05</b>  <b>Reconsideration of IPP – Transpower</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower's IPP may be reconsidered if one of the following events has occurred:</p> <ul style="list-style-type: none"> <li>• a catastrophic event, for which the costs of rectifying the impact of the event is material; or</li> <li>• a material error is discovered in the determination; or</li> <li>• Transpower has provided false or misleading information, which the Commission has relied upon in making its determination; or</li> <li>• a change in legislative or regulatory requirements that has a material impact on Transpower's costs.</li> </ul> <p>See section 7.4 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>The amendment affects the IMs relating to individual price-quality regulation for Transpower.</p> <p>It will apply with effect from 1 July 2015, which corresponds to the commencement date of the first disclosure year for RCP2.</p> <p>We have amended the provisions relating to reconsideration of Transpower's IPP by replacing the term 'quality targets' with terminology that reflects the quality standards framework applying under the Capex IM.</p> <p>The new terminology is that of 'revenue-linked grid output measures', involving 'grid outputs', 'grid output targets', 'caps', 'collars' and 'grid output incentive rates', whereas the previous terminology reflected the quality targets set in the 2010 IPP.</p> <p>The change allows the revenue-linked grid output measures specified in an IPP determination to be amended following a catastrophic event, error, or change event, as provided for in the price-quality path reconsideration provisions in the IMs.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Transpower</p>

*How we propose changing this decision*

352. Our draft decision is to change IM decision RP05 to:

352.1 expand the scope of the existing ‘error’ reopener provision; and

352.2 introduce a new reopener provision to allow NCA and s 52Q workability fixes to apply to an IPP when they result in a non-equivalent effect on the price-quality path.

*Why we propose making these changes*

Expanded error reopener provision

353. We propose making this change to IM decision RP05 for the same reasons as above for IM decision RP01.

Reconsideration to apply workability fixes

354. We propose making this change to IM decision RP05 for the same reasons as above for IM decision RP01.

**Existing Reconsideration of the price-quality path IM decision RP06**

<b>Decision RP06</b> <b>Meaning of ‘material’ for purposes of reconsideration – Transpower</b>	<b>Original 2010 decision</b> In this context, material means that the total effect of the event on the price path is at least 1% of the aggregated forecast MARs for the years in which the costs associated with the event are incurred.  See section 7.4 of 2010 IM Transpower reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

*Why we propose changing this decision*

355. We propose amending IM decision RP06 to change the 1% materiality threshold on allowable revenue so that the error reopener would only apply to errors in allowable revenue, rather than errors that might affect other aspects of the price-quality path. This would exclude all other aspects of the price-quality path, for example, quality standards.

356. The reasons for this proposed change are the same as those discussed under IM decision RP03.

### Existing reconsideration of the price-quality path IM decision RP07

<p><b>Decision RP07</b> Annual reconsideration for effect of major capex and listed projects – Transpower  (original decision amended)</p>	<p><b>Original 2010 decision</b> Transpower's IPP will be reconsidered annually to take account of the revenue impact of major capex approved by the Commission; and an economic value (EV) adjustment.  See section 7.4 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b> The amendment provides a mechanism for Transpower to apply for, and the Commission to approve, additional base capex for inclusion within Transpower's price path during a regulatory period in respect of large scale replacement and refurbishment projects, which are referred to as 'listed projects'.  The amendments took effect when they were published by notice in the <i>Gazette</i>, on 27 November 2014:  Amended the price path reconsideration provision in the Transpower IM to accommodate the revenue impact of approved base capex in respect of listed project assets that are forecast to be commissioned in a regulatory period.  <a href="#">Amendments to input methodologies for Transpower to provide a listed project mechanism: Reasons paper (27 November 2014)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

#### *How we propose changing this decision*

357. We propose amending the original decision to add a further category of adjustment to the annual wash-up of Transpower's price-quality path. In the capital charge, the revenue wash-up would be adjusted for differences between the forecast CPI used when setting the WACC rate and the actual CPI. The existing EV account mechanisms in Transpower's IPP Determination would apply to take account of the adjustment in a future pricing year.

#### *Why we propose making this change*

358. These are consequential amendments as a result of the proposed changes described under IM decision SP08.

## Chapter 10: IRIS decisions we propose changing

### Existing IRIS IM decision IR02

<p><b>Decision IR02</b></p> <p><b>Treatment of IRIS balances – EDBs</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>While both incremental gains and losses will be carried forward to the subsequent 5 years, only positive net balances of such gains and losses in years in the next regulatory period will be treated as recoverable costs. (ie, only net rewards will be recognised).</p> <p>See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>We put in place an incentive to control expenditure that is the same in each year of the regulatory period. Unlike the pre-existing asymmetric IRIS for opex, the revised IRIS would provide incentives that are the same in each year:</p> <ul style="list-style-type: none"> <li>• For opex, the retention period for savings and losses is 5 years following the year of the gain and loss, which is equivalent to a retention factor of around 35% for a supplier.</li> <li>• ... the strength of the incentive applying to capex can be varied relative to the incentive strength applying to opex. The choice of retention factor for capex will be decided at the time of each reset.</li> </ul> <p>In the second full year after the price-quality path starts to apply to the supplier, a one-off adjustment is made after the carry forward amounts are added together.</p> <p>The one-off adjustment in the second year is required to correct for the difference between the actual and assumed level of opex in the final year of the preceding price-quality path. This adjustment is required because the incremental change in the final year of a price-quality path is assumed to be nil.</p> <p><a href="#">Amendments to input methodologies for electricity distribution services and Transpower New Zealand: Incremental Rolling Incentive Scheme (27 November 2014)</a></p> <p><b>2015 amendment to this decision (2)</b></p> <p>We made further amendments intended to address situations in which a distributor transitions back and forth between default and CPPs.</p> <p>The situation in which a distributor transitions onto a CPP provides different incentives compared to the situations under a DPP and IPP.</p>
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	<p>After considering the options proposed by submitters we determined that retaining an IRIS and implementing the approach proposed by Powerco was most appropriate given the circumstances of a CPP as it provides the most beneficial incentives on suppliers:</p> <ul style="list-style-type: none"> <li>• In its submission, Powerco suggested an approach in which the temporary savings in the penultimate year are assumed to be the difference between forecast and actual opex in that year.</li> <li>• Under the Powerco approach, the correct adjustments are made through the baseline adjustment term for any temporary savings in the penultimate year (eg, year 4).</li> </ul> <p><a href="#">Further amendments to input methodologies for electricity distributors subject to price-quality regulation - Incremental Rolling Incentive Scheme (IRIS) (25 November 2015)</a></p>
<b>This original decision applies to (sector):</b>	EDBs

*We propose an implementation change for this decision*

359. We propose changing IM decision IR02 to amend the EDB IM ‘opex incentive amount’ calculation to fit the purpose of the ‘adjustment to the opex incentive’ by using a modified version of the ‘capex incentive adjustment’ calculation.

*Why we propose making this change*

360. Currently, under the EDB IRIS, when an adjustment to the opex incentive is made, the entire adjustment falls in the second year of the regulatory period.<sup>86</sup>

361. Under this approach there is a risk of fluctuations in allowable revenue (and therefore prices to consumers) resulting from these second year adjustments.

362. We therefore propose drafting amendments to resolve the problem by spreading the IRIS adjustment across the remainder of the regulatory period. An existing solution is available in the ‘capex incentive adjustment’ calculation formula.

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<sup>86</sup> Vector raised a concern about this in: Vector “Commission Proposal to Implement Further Amendments to Input Methodologies (IM) for Electricity Distributors Subject to Price Quality Regulation” (20 March 2015) para 18.

## Existing IRIS IM decision IR05

<b>Decision IR05</b> <b>Treatment of IRIS balances – Transpower</b>  <b>(original 2010 decision amended)</b>	<p><b>Original 2010 decision</b></p> <p>While both incremental gains and losses will be carried forward to the subsequent 5 years, only positive net balances of such gains and losses in years in the next regulatory period will be treated as recoverable costs (ie, only net rewards will be recognised).</p> <p>See section 7.5 of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>We put in place an incentive to control expenditure that is the same in each year of the regulatory period. Unlike the pre-existing asymmetric IRIS for opex, the revised IRIS provides incentives that are the same in each year.</p> <p>For opex, the retention period for savings and losses is 5 years following the year of the gain and loss, which is equivalent to a retention factor of around 35% for a supplier.</p> <p>In the second full year after the price-quality path starts to apply to the supplier, a one-off adjustment is made after the carry forward amounts are added together.</p> <p>The one-off adjustment in the second year is required to correct for the difference between the actual and assumed level of opex in the final year of the preceding price-quality path. This adjustment is required because the incremental change in the final year of a price-quality path is assumed to be nil.</p> <p><a href="#">Amendments to input methodologies for electricity distribution services and Transpower New Zealand: Incremental Rolling Incentive Scheme (27 November 2014)</a></p>
<b>This original decision applies to (sector):</b>	Transpower

### *We propose an implementation change for this decision*

363. We propose changing IM decision IR05 to amend the Transpower IM ‘opex incentive amount’ calculation to fit the purpose of the ‘adjustment to the opex incentive’ by using a modified version of the ‘capex incentive adjustment’ calculation. This is consistent with the change to IM decision IR02 proposed for EDBs.

### *Why we propose making this change*

364. We propose changing this approach for the same reasons outlined under IM decision IR02.

### Existing IRIS IM decision IR08

<b>Decision IR08</b> <b>IRIS to apply under a CPP – GDBs and GTBs</b>	<b>Original 2010 decision</b> <p>The Commission will implement an IRIS under a CPP. The efficiency gain or loss for a particular year will be calculated as the difference between actual and forecast controllable opex for the current year, minus the difference in the preceding year, the result of which provides the incremental gain/loss for that year.</p> <p>See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	GDB/GTB

#### *How we propose changing this decision*

365. We propose removing the current asymmetric opex IRIS applying to CPPs for gas pipeline services.

#### *Why we propose making this change*

366. Our emerging views on the IRIS for the GDB and GTB DPPs and CPPs, as outlined in our gas process and issues paper,<sup>87</sup> were (in summary):

366.1 the benefits from implementing a capex and opex IRIS for gas pipeline services would be unlikely to outweigh the costs at this time; and

366.2 if IRIS is not implemented for gas pipeline services in the 2017 Gas DPP resets, the current asymmetric opex IRIS applying to CPPs should be removed for gas pipeline services.

367. Submissions in relation to IRIS and the Gas DPP resets were received on 24 March 2016 from GasNet Limited, Methanex New Zealand Limited, First State Investments, Maui Development Limited and Powerco.<sup>88</sup>

<sup>87</sup> Commerce Commission "Default price-quality paths for gas pipeline services from 1 October 2017 – Process and issues paper" (29 February 2016), paras 5.1-5.15.

<sup>88</sup> GasNet "Submission on DPP from 2017 for gas pipeline services, process and issues paper – Public version" (24 March 2016), p. 5; Methanex "Gas default price-quality path reset 2017 and other matters" (24 March 2016), p. 2; First State Investments "Gas default price-quality path: Matters related to the input methodologies" (24 March 2016), pp. 1-2; MDL, Untitled comments on Gas DPP process and issues paper (24 March 2016), p. 2; and Powerco "Submission on the four emerging view papers (29 February 2016)" (24 March 2016), pp. 3 and 10.

368. Overall, submissions commenting on IRIS issues generally supported the Commission's emerging views. Powerco and MDL specifically supported our emerging view regarding the existing asymmetric opex IRIS applying in respect of CPPs, and agreed that it should be removed altogether.
369. This proposed change also applies to IM decisions IR09 and IR10.

#### Existing IRIS IM decision IR09

<b>Decision IR09</b> <b>Treatment of IRIS balances – GDBs and GTBs</b>	<b>Original 2010 decision</b> While both incremental gains and losses will be carried forward to the subsequent 5 years, only positive net balances of such gains and losses in years in the next regulatory period will be treated as recoverable costs (ie, only net rewards will be recognised).  See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

#### *How we propose changing this decision*

370. We propose removing the current asymmetric opex IRIS applying to CPPs for gas pipeline services.<sup>89</sup>

#### *Why we propose making this change*

371. Our reasons for proposing this change are the same as the reasons set out under IM decision IR08.

<sup>89</sup> Commerce Commission "Default price-quality paths for gas pipeline services from 1 October 2017 – Process and issues paper" (29 February 2016), paras 5.14-5.15.

**Existing IRIS IM decision IR10**

<b>Decision IR10</b> <b>Five-year retention of efficiency gains</b>	<b>Original 2010 decision</b> The length of time suppliers are allowed to retain the efficiency gain is 5 years.  See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

*How we propose changing this decision*

372. We propose removing the current asymmetric opex IRIS applying to CPPs for gas pipeline services.<sup>90</sup>

*Why we propose making this change*

373. Our reasons for proposing this change are the same as the reasons set out under IM decision IR08.

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<sup>90</sup> Commerce Commission "Default price-quality paths for gas pipeline services from 1 October 2017 – Process and issues paper" (29 February 2016), paras 5.14-5.15.

## **Part 2: IM decisions that we do not propose changing**

### **Chapter 11: Introduction to Part 2**

374. This Part lists those existing IM decisions:

374.1 in light of our framework, submissions on the IM review so far, and all other relevant information before us, we considered changing; but

374.2 for the reasons presented in this Part, we do not propose changing (either at a policy level, or in terms of the implementation of the policy decision) at this stage.

375. For each existing IM decision that we do not propose changing, this Part:

375.1 states the existing decision; and

375.2 explains why we do not propose changing it as part of the IM review.

376. Like Part 1, this Part is structured according to the grouping of IM decisions described at paragraph 20 in the introduction to this report.

## Chapter 12: Cost allocation decisions we do not propose changing

### Existing cost allocation IM decision CA02

<b>Decision CA02</b> <b>Allocating not directly attributable cost</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs [ie, GDBs and GTBs] must apply one of three complementary approaches to allocate costs that are 'not directly attributable' between each type of regulated service, and between the regulated and unregulated services (in aggregate) they provide:</p> <ul style="list-style-type: none"> <li>• the ABAA;</li> <li>• the optional variation to the accounting based approach (<b>OVABAA</b>); and</li> <li>• ACAM.</li> </ul> <p>See section 3.3, Appendix B, sections B4 to B6 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	EDB/GDB/GTB

#### *Why we do not propose changing this decision*

377. Our draft decision in respect of IM decision CA02 is to make no change.

#### Implementation changes relating to cost definitions generally

378. In our problem definition paper we proposed a focus on cost definitions to reduce complexity and compliance costs.<sup>91</sup> We received submissions from PwC and ENA on this point.<sup>92</sup> They both supported aligning cost definitions within the IMs as closely to the GAAP rules as possible, but no specific changes were suggested, and no other submissions mentioned this matter.

<sup>91</sup> Commerce Commission “Input methodologies review invitation to contribute to problem definition” (16 June 2015), paras 484-485.

<sup>92</sup> PwC “Submission to the Commerce Commission on input methodologies review: Invitation to contribute to problem definition (21 August 2015), para 146; and ENA’s submission on the problem definition paper “Response to the Commerce Commission’s input methodologies review paper” (21 August 2015), paras 223-224.

379. In reviewing IM decision CA02, we looked at whether we could reduce complexity and compliance costs by using techniques such as alignment with GAAP, while continuing to achieve the policy intent. In doing so we found cases where we can align the IMs closer with GAAP or other commercial rules, such as the auditing standards, to help reduce complexity and compliance costs. For example:
- 379.1 the implementation change to IM decision AV17 to GAAP accounting methods to be used for the depreciation of non-system assets;
  - 379.2 the implementation change to IM decisions AV13, AV14 and AV33 so that the financing cost on works under construction aligns with GAAP; and
  - 379.3 the implementation change to the CPP audit requirements so they better align with the auditing standards.<sup>93</sup>
380. We have not identified any other areas where a change to the IMs to align them more closely with GAAP is justified.

Implementation changes relating to disclosure of unregulated revenue

381. Currently, we do not require regulated suppliers to report unregulated revenues to us. This means it is difficult for us to determine total unregulated revenue for assessing compliance with the revenue materiality threshold.
382. Although we are not proposing to amend IM decision CA02, we are taking the opportunity to signal that we intend to consult on amending the ID requirements in order to ensure that we receive information on unregulated income to allow us to better assess whether parties fall under the revenue materiality threshold. Our reasons are:
- 382.1 we consider that regulated businesses should provide unregulated revenue information in order to allow us to determine whether they are permitted to use the ACAM approach by virtue of being under the Regulated Revenue Materiality Threshold; and
  - 382.2 we consider that unregulated revenue information should not be particularly burdensome for businesses to provide.
383. In reviewing IM decision CA02, we also considered whether using a level of 1%-2% of regulated revenue remained the standard for determining if use of ACAM remains appropriate. As discussed in Topic paper 3: The future impact of emerging technologies in the energy sector, our view is that it does remain appropriate – we have not seen any evidence that would change our view.

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<sup>93</sup> Commerce Commission “Input methodologies review draft decisions: Topic paper 2 – CPP requirements” (16 June 2016), chapter 7.

### Option to apply the OVABAA cost allocation approach

384. We have also considered whether the option to apply OVABAA is still required, given no suppliers have used this option to date.
385. ENA and PwC submitted that there is value in OVABAA remaining in the IMs, particularly as in the future EDBs may invest more in less traditional assets.<sup>94</sup> We agree that emerging technologies mean that fewer companies are eligible to use the ACAM approach and, as such, we propose retaining the OVABAA option.
386. We have also considered whether, under the OVABAA option, we could replace director certification with manager-level certification. We have proposed to use this approach to address the proxy allocator issue discussed under IM decision CA04. However, we do not propose using this approach in IM decision CA02. We consider that the question of whether the provision of a service is unduly deterred is a question best answered at a strategic level and director-level sign off continues to be appropriate.

### **Existing cost allocation IM decision CA05**

<b>Decision CA05</b> <b>Definition of causal relationships</b>	<p><b>Original 2010 decision</b></p> <p>'Causal relationships' are defined in relation to:</p> <ul style="list-style-type: none"> <li>• asset values, as a circumstance in which a factor influences the utilisation of an asset during the 18 month period terminating on the last day of the disclosure year in respect of which the allocation is carried out; and</li> <li>• operating costs, as a circumstance in which a cost driver leads to an operating cost being incurred during the 18 month period terminating on the last day of the disclosure year in respect of which the allocation is carried out.</li> </ul> <p>See Appendix B, section B4 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p>Airports – see Appendix B of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<sup>94</sup> ENA's submissions on the problem definition paper "Response to the Commerce Commission's input methodologies review paper" (21 August 2015), para 222. PwC "Submission to the Commerce Commission on input methodologies review: Invitation to contribute to problem definition" (21 August 2015), para 145.

*Why we do not propose changing this decision*

387. Our draft decision in respect of IM decision CA05 is to make no change.
388. Horizon submitted in 2013 that we should provide clarity about the time period over which a causal relationship (for cost allocation) has to be established when a regulated supplier has acquired a business in the last 18 months.<sup>95</sup> The time period for a causal relationship is relevant for determining what causal (or proxy) allocators a business can apply.
389. The intent of the IM is that a causal relationship can be established over any part of the 18 month period. We do not propose amending the IM determinations, as the allocator is working as intended.

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<sup>95</sup> Commerce Commission “Issues register for electricity and gas information disclosure” (30 March 2016). See row 79 regarding the clarification sought by Horizon on 28 June 2013).

### Existing cost allocation IM decision CA11

<b>Decision CA11</b> <b>Allocating not directly attributable cost – Airports</b>	<b>Original 2010 decision</b> Airports must apply ABAA to allocate costs that are ‘not directly attributable’ between each of the three regulated activities, and between regulated and unregulated activities they undertake.  See section 3.3 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

#### *Why we do not propose changing this decision*

390. Our draft decision in respect of IM decision CA11 is to make no change.

391. The Board of Airline Representatives New Zealand (**BARNZ**) originally submitted that the cost allocation IM relating to assets that are not directly attributable is too broad.<sup>96</sup> However, BARNZ subsequently withdrew this submission.<sup>97</sup> There is no other evidence of an issue in this area, and therefore, we are not proposing to make any changes to IM decision CA11.

<sup>96</sup> BARNZ “Submission by BARNZ on problem definition paper for the input methodologies review” (21 August 2015), pp. 1-2.

<sup>97</sup> Letter from Kristina Cooper (Legal and Regulatory Manager, BARNZ) to Hazel Burns (Senior Analyst, Commerce Commission) confirming that BARNZ withdraws its submission on the asset allocator issue, made as part of its submission on the Commission’s Problem definition paper (14 June 2016), available on our website at: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/>.

## Chapter 13: Asset valuation decisions we do not propose changing

### Existing asset valuation IM decision AV03

<b>Decision AV03</b> <b>RAB roll forward with indexation</b>	<b>Original 2010 decision</b> EDBs and GPBs must roll forward the RAB values of their assets using CPI-indexation. For this purpose EDBs and GPBs must use the 'All Groups Index SE9A' published by Statistics New Zealand.  See section 4.3, Appendix E, section E12 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *Why we do not propose changing this decision*

392. Our draft decision in respect of IM decision AV03 is to make no change.
393. We discussed issues relating to suppliers' exposure to inflation risk and the time profile of capital recovery in Topic paper 1: Form of control and RAB indexation.
394. Our reasons for proposing not to change this decision in response to these issues are discussed in Topic paper 1: Form of control and RAB indexation.

## Existing asset valuation IM decision AV04

<b>Decision AV04</b> <b>RAB exclusions</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs should exclude from their RAB values:</p> <ul style="list-style-type: none"> <li>• as applicable, any assets not used to provide electricity lines services (as defined by s 54C) and any assets not used to provide gas pipeline services (as defined by s 55A);</li> <li>• any asset that is part of a works under construction;</li> <li>• working capital;</li> <li>• goodwill; and</li> <li>• easement land, that is land acquired for the purpose of creating an easement and with the intention of subsequently disposing of the land.</li> </ul> <p>See section 4.3, Appendix E, sections E2, E3, E5, E6 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

### *Why we do not propose changing this decision*

395. Our draft decision in respect of IM decision AV04 is to make no change.
396. We considered Electricity Retailers' Association of New Zealand's (**ERANZ**) submission for effectively excluding certain assets from the RAB (eg, batteries beyond the meter, even if used to supply regulated services).<sup>98</sup>
397. Our reasons for not proposing changes to this decision, including our response to ERANZ's submission, are discussed in Topic paper 3: The future impact of emerging technologies in the energy sector.

<sup>98</sup> Electricity Retailers' Association of New Zealand (ERANZ), "Submission of Emerging Technologies – Workshop and Pre-workshop paper" (4 February 2016), pp. 18-20.

### Existing asset valuation IM decision AV18

<b>Decision AV18</b> <b>Assets retained in RAB for ID</b>	<b>Original 2010 decision</b> Where demand for the asset falls away, regulated suppliers may retain the asset in the RAB value for the purpose of ID, and continue to depreciate the asset over its remaining asset life.  See section 11 Appendix E of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *Why we do not propose changing this decision*

398. Our draft decision in respect of IM decision AV18 is to make no change.
399. The issue of asset stranding is discussed in Topic paper 3: The future impact of emerging technologies in the energy sector. Although we do not propose amending IM decision AV18, we are proposing an amendment to IM decision AV17, to allow EDBs the option to adjust asset lives by a moderate amount in certain circumstances.
400. Details of this proposed change to IM decision AV17 are set out in Part 1 above.

### Existing asset valuation IM decision AV26

<b>Decision AV26</b> <b>No indexation of RAB – Transpower</b>	<b>Original 2010 decision</b> No indexation is to be applied in rolling forward Transpower's RAB value.  See section 4.3, paragraphs 4.4.68-4.4.80 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

#### *Why we do not propose changing this decision*

401. Our draft decision in respect of IM decision AV26 is to make no change.
402. We discussed issues relating to Transpower's exposure to inflation risk and the time profile of capital recovery in Topic paper 1: Form of control and RAB indexation.
403. Our reasons for proposing not to change this decision in response to these issues are discussed in Topic paper 1: Form of control and RAB indexation.

**Existing asset valuation IM decision AV29**

<b>Decision AV29</b> <b>Asset disposals –</b> <b>Transpower</b>	<b>Original 2010 decision</b> Where Transpower disposes of an asset, the closing RAB value of that asset, for the disclosure year in which the disposal occurs, is nil.  See section 4.3, paragraphs 4.4.68-4.4.80 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

*Why we do not propose changing this decision*

404. Our draft decision in respect of IM decision AV29 is to make no change.
405. We considered whether IM decision AV29 should be changed to accommodate write-offs and dismantling costs for Transpower assets which have been fully depreciated.
406. However, it appears that the price path would already take account of assets' end of life costs such as dismantling and write-offs:
- 406.1 Under GAAP, the gain or loss arising from the “derecognition” of an item of property, plant and equipment is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item. The gain or loss is included in profit or loss when the item is derecognised.<sup>99</sup>
- 406.2 “Net disposal proceeds” is interpreted to include the costs associated with disposing of an asset (eg, dismantling and write-offs) and use of the word ‘net’ suggests this could be negative.
- 406.3 The loss from derecognising (ie, disposing of) an asset due to dismantling costs and write-offs would therefore meet the definition of an operating cost under the Transpower IM Determination and, in turn, be included with other operating costs for the purposes of Transpower’s IPP under the IMs.

<sup>99</sup> See: New Zealand Equivalent to International Accounting Standard 16 (NZ IAS 16), para 67-72.

### Existing asset valuation IM decision AV43

<p><b>Decision AV43</b>  <b>Financing costs on works under construction – Airports</b></p>	<p><b>Original 2010 decision</b></p> <p>Airports must capitalise financing costs on works under construction consistent with GAAP, at a rate no greater than the Airport's estimate of its post-tax cost of capital. Airports must cease capitalising financing costs when the asset is commissioned.</p> <p>When works under construction are commissioned, airports must reduce the cost of the asset, established consistent with GAAP, by the amount of any revenue derived in relation to the assets while they were works under construction (where such a reduction is not already made under GAAP, and where the revenue has not already been reported as income under ID).</p> <p>See section 4.3, Appendix C, section C4 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Airports</p>

#### *Why we do not propose changing this decision*

407. Our draft decision in respect of IM decision AV43 is to make no change.
408. We have considered amending IM decision AV43 for consistency between the Airport IMs and the IMs that apply to the other sectors, particularly exempt EDBs. However, we note that the interest during construction cap never applied to airports, and there would not be the same benefit of maintaining consistent disclosures as between exempt EDBs and non-exempt EDBs (IM decision AV14). Therefore, we are not proposing to change this decision.

## Existing asset valuation IM decision AV54

<p><b>Decision AV54</b>  <b>Initial RAB value – Powerco GDB</b>   <b>(2013 decision)</b></p>	<p><b>Original 2013 decision</b></p> <p>Our final decision in June 2012 was to effect a change to Powerco’s year-end to 30 September and leave the remaining gas businesses disclosure year-ends unchanged. This ensures that that correct initial RAB value for Powerco is established as of the commencement date of the Part 4 regulatory regime. The initial RAB values for Vector and GasNet remain unchanged.</p> <p>As discussed in our final decision, the amendments include an adjustment to Powerco’s initial RAB values for the 3-month period 30 June to 30 September 2009.</p> <p>The changes will take effect from the date of amendment. Calculations of RAB values and other values (such as roll forward deferred tax balances) will incorporate the effect of the changes so that, for example, the effect of the changes on RAB values will be apparent from 2009 in the upcoming 2013 gas distribution ID for Powerco.</p> <p><a href="#">Implementing the change to Powerco’s disclosure year: Technical briefing paper on amendments to gas input methodologies (3 December 2013)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>GDBs (Powerco only)</p>

### *Why we do not propose changing this decision*

409. Our draft decision in respect of IM decision AV54 is to make no change.
410. We have previously committed to assessing the benefits of a common disclosure year.<sup>100</sup> As part of the IM review, we have therefore considered whether IM decision AV54 should be amended to impose a common disclosure year for all GPBs.
411. At this stage, we do not propose aligning the disclosure year for all GPBs as part of the IM review because:
- 411.1 making this change would cause an increased compliance burden; and
  - 411.2 on the information before us, we do not consider that this would be outweighed by the benefits of an IM change to align the disclosure year for all GPBs.

<sup>100</sup> Commerce Commission, “Consultation on Electricity and Gas Input Methodology Determination Amendments 2012” (11 May 2012), p 11-16.

412. Suppliers have previously cited the increased compliance burden a change to a common disclosure year would impose. However the upcoming industry changes brought about by the industry asset acquisitions by First State Gas (**FSG**) may result in a reconsideration of the costs and benefits.
413. We are interested in GPBs' views (and reasons) on whether they would prefer to change to a common disclosure year in light of the FSG transactions. If GPBs indicate a willingness to change their financial reporting, the IMs could potentially be changed to facilitate a common disclosure year.
414. Our preferred reporting year is the year ended 30 September, which is currently Powerco Gas's reporting period.
415. We understand that FSG might also align its New Zealand financial reporting with our preferred 30 September disclosure year.
416. We invite the other regulated entities that wish to align their disclosure year with our preferred 30 September disclosure year to indicate their support for this option in their submissions.

## Chapter 14: Treatment of taxation decisions we do not propose changing

### Existing treatment of taxation IM decision TX02

<p><b>Decision TX02</b></p> <p><b>Tax legislation and cost allocation to be applied – EDBs</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>When calculating regulatory taxable income, the cost allocation IM and tax legislation (to the extent practicable) are to be used, subject to other relevant provisions in the IMs. Debt interest should be calculated using a notional leverage that is consistent with the cost of capital IM.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendments to this decision</b></p> <p>See para 2.2, 2.3, 3.2, 3.3, 4.2, 4.3 – Electricity Distribution Services Input Methodology Amendments Determination 2014 [2014] NZCC 31 (27 November 2014).</p> <p><i>Definition of notional deductible interest</i></p> <p>This amendment changes the definition of notional deductible interest used in the treatment of taxation IMs to apply a mid-year cash-flow timing assumption to the calculation of notional interest amounts. The current IMs assume year-end payments rather than payments being made during the year.</p> <p>The amendment provides formulas that assume interest payments are to be made continuously through the year at a constant rate, which would be closely equivalent to a single interest payment being made at mid-year. The interest payable amount is discounted using the cost of debt.</p> <p><i>Correction to double deduction of TCSD allowance</i></p> <p>This amendment corrects the double deduction of the TCSD allowance when calculating the regulatory tax allowance for the treatment of taxation IMs for DPPs.</p> <p>The TCSD is included as a deduction in the definitions of both the regulatory profit / (loss) before tax and the regulatory tax adjustments and clause 4.3.1 uses these two terms to derive the regulatory tax allowance. As a result, the TCSD allowance is incorrectly deducted twice when calculating the regulatory tax allowance.</p> <p><i>Correction to amortisation of initial differences</i></p> <p>This amendment corrects the definition of amortisation of initial differences in asset values to take account of the changes in initial difference values that result from the age, sale and acquisition of relevant assets.</p>
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	<p>Clause 4.3.3(3) defines the ‘amortisation of initial differences in asset values’ for each disclosure year as the ‘initial differences in asset values’ divided by the ‘weighted average remaining useful life of relevant assets’.</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p>
<b>This decision applies to (sector):</b>	EDBs

*Why we do not propose changing this decision*

417. In respect of IM decision TX02, our draft decision is to make no change.
418. We considered ENA and PwC’s submission on the issue of whether the definition for ‘weighted average remaining useful life of relevant assets’ needs to be defined in the IM determinations.<sup>101</sup>
419. We consider that the ID requirements provide appropriate guidance to interpret the term and we have decided not to change the IMs in this regard. Our guidance to suppliers is to use the EDB and GDB ID definition of “opening weighted average remaining useful life of relevant assets (years)” when applying the term “weighted average remaining useful life of relevant assets” in the EDB and GDB IM Determinations.

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<sup>101</sup> ENA and PwC “Review of input methodologies” (14 February 2014), para 17.

## Chapter 15: Cost of capital decisions we do not propose changing

### Existing cost of capital IM decision CC01

<b>Decision CC01</b> <b>Cost of capital defined as estimate of WACC</b>	<p><b>Original 2010 decision</b></p> <p>The cost of capital is an estimate of firms' WACC which reflects the cost of debt and the cost of equity used to fund investment. A different WACC will apply in respect of the supply of regulated services by EDBs and GPBs.</p> <p>See sections 6.1, H1, H2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *Why we do not propose changing this decision*

420. Our draft decision is not to change IM decision CC01 or the way it is implemented. We have reached this conclusion having considered MDL's submission that we should change our approach to setting the WACC to account for individual business needs. Our response to this issue is explained under IM decision CC03 in Part 1 of this report.

### Existing cost of capital IM decision CC02

<b>Decision CC02</b> <b>WACC percentile</b>  <b>(original 2010 decision amended)</b>	<p><b>Original 2010 decision</b></p> <p>To incentivise efficient investment in regulated services (given the possibility of errors in estimating the WACC) the WACC to apply for DPP and CPPs is specified as the 75<sup>th</sup> percentile estimate of the WACC.</p> <p>See section 6.7, H11 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>This amendment gives effect to the Commission's decision to move from using the 75<sup>th</sup> percentile estimate of WACC to the 67<sup>th</sup> percentile estimate of WACC for the purposes of price-quality regulation for electricity lines services and gas pipeline services.</p> <p>Our decision was that the specified WACC for EDBs, Transpower and GPBs should be amended, in light of evidence gathered since the IMs were first determined in December 2010. Our decision was that the 67<sup>th</sup> percentile of our estimated WACC distribution should be used for price-quality path regulation (the 75<sup>th</sup> percentile is currently used). Our decision has been given effect by amending the cost of capital IMs applying to those businesses.</p>
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	<p>This decision does not amend the WACC percentile range used for ID regulation. This amendment to the WACC percentile will apply to EDBs on a DPP and to Transpower's IPP when the resets of those price-quality paths take effect in 2015:</p> <p><a href="#">Amendment to the WACC percentile for price-quality regulation for electricity lines services and gas pipeline services: Reasons paper (30 October 2014)</a></p>
<b>This original decision applies to (sectors):</b>	EDB/GDB/GTB

*Why we do not propose changing this decision*

421. Our draft decision is not to change IM decision CC02 or the way it is implemented. Our reasons for not proposing to change this decision are discussed in Topic paper 4: Cost of capital issues.

**Existing cost of capital IM decision CC08**

<b>Decision CC08</b> <b>Corporate tax rate in WACC estimates</b>	<p><b>Original 2010 decision</b></p> <p>The corporate tax rate is 30% up until the end of the 2011 tax year, and 28% thereafter. Changes in the corporate tax rate will flow through to future post-tax WACC estimates automatically.</p> <p>See section 6.5, H10 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*Why we do not propose changing this decision*

422. Our draft decision is not to change IM decision CC08 or the way it is implemented. Our reasons for not proposing to change this decision are discussed in Topic paper 4: Cost of capital issues.

**Existing cost of capital IM decision CC09**

<b>Decision CC09</b> <b>Commercially realistic estimates of WACC</b>	<b>Original 2010 decision</b> We have compared the estimated WACCs under the IM against a range of other financial and economic information in order to check that the application of the cost of capital IM produces commercially realistic estimates of WACC for EDBs and GPBs.  See section 6.8, H13 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*Why we do not propose changing this decision*

423. Our draft decision is not to change IM decision CC09. We have continued to conduct reasonableness checks which are discussed in Topic paper 4: Cost of capital issues.

**Existing cost of capital IM decision CC12**

<b>Decision CC12</b> <b>WACC percentile –</b> <b>Transpower</b>  <b>(original 2010</b> <b>decision amended)</b>	<p><b>Original 2010 decision</b></p> <p>To incentivise investment in regulated services (given the possibility of error in estimating the WACC) the 75<sup>th</sup> percentile estimate of the vanilla WACC will be applied under the IPP.</p> <p>See section 6.7, H11 of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>This amendment gives effect to the Commission's decision to move from using the 75<sup>th</sup> percentile estimate of WACC to the 67<sup>th</sup> percentile estimate of WACC for the purposes of price-quality regulation for electricity lines services and gas pipeline services. This decision does not amend the WACC percentile range used for ID regulation.</p> <p>Our decision is that the specified WACC for EDBs, Transpower and GPBs should be amended, in light of evidence we have gathered since the IMs were first determined in December 2010. Our decision is that the 67<sup>th</sup> percentile of our estimated WACC distribution should be used for price-quality path regulation (the 75<sup>th</sup> percentile is currently used). Our decision has been given effect by amending the cost of capital IMs applying to those businesses.</p> <p>This amendment to the WACC percentile will apply to EDBs on a DPP and to Transpower's IPP when the resets of those price-quality paths take effect in 2015.</p> <p><a href="#">Amendment to the WACC percentile for price-quality regulation for electricity lines services and gas pipeline services: Reasons paper (30 October 2014)</a></p>
<b>This original decision</b> <b>applies to (sector):</b>	Transpower

*Why we do not propose changing this decision*

424. Our draft decision is not to change IM decision CC12 or the way it is implemented. Our reasons for not proposing to change this decision are discussed in Topic paper 4: Cost of capital issues.

## Existing cost of capital IM decision CC13

<p><b>Decision CC13</b>  <b>Commission to publish annual WACC estimates – Transpower</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>The Commission will:</p> <ul style="list-style-type: none"> <li>• publish annually a mid-point estimate of the 5-year vanilla and post-tax WACC, as well as 25<sup>th</sup> and 75<sup>th</sup> percentile estimates of vanilla and post-tax WACC, to apply under ID regulation; and</li> <li>• determine, as at 7 months prior to the start of the regulatory period, an estimate of a 5-year vanilla WACC at the 75<sup>th</sup> percentile to apply in setting the IPP for Transpower. The Commission will publish this WACC no later than one month after estimating it.</li> </ul> <p>For the 2010–2015 regulatory control period (<b>RCP1</b>), the Commission will determine the WACC to apply as soon as practicable after the IM comes into force.</p> <p>See sections 6.7, 6.2 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>This amendment gives effect to the Commission's decision to move from using the 75<sup>th</sup> percentile estimate of WACC to the 67<sup>th</sup> percentile estimate of WACC for the purposes of price-quality regulation for electricity lines services and gas pipeline services. This decision does not amend the WACC percentile range used for ID regulation.</p> <p>Our decision is that the specified WACC for EDBs, Transpower and GPBs should be amended, in light of evidence we have gathered since the IMs were first determined in December 2010. Our decision is that the 67<sup>th</sup> percentile of our estimated WACC distribution should be used for price-quality path regulation (the 75<sup>th</sup> percentile is currently used). Our decision has been given effect by amending the cost of capital IMs applying to those businesses.</p> <p>This amendment to the WACC percentile will apply to EDBs on a DPP and to Transpower's IPP when the resets of those price-quality paths take effect in 2015.</p> <p><a href="#">Amendment to the WACC percentile for price-quality regulation for electricity lines services and gas pipeline services: Reasons paper (30 October 2014)</a></p> <p><b>2014 amendment to this decision (2)</b></p> <p>Our decision is not to amend the 25<sup>th</sup> to 75<sup>th</sup> percentile range for ID for electricity lines services and gas pipeline services. These percentile estimates of WACC will continue to be determined and published annually, along with the mid-point estimate (which is also currently published annually).</p>
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	<p>We will annually determine and publish 67<sup>th</sup> percentile estimates so that these are available to ourselves and other interested persons to be used in analysing the performance of suppliers.</p> <p><a href="#">Amendments to the WACC percentile range for information disclosure regulation for electricity lines services and gas pipeline services: Reasons Paper (12 December 2014)</a></p>
<b>This original decision applies to (sector):</b>	Transpower

*Why we do not propose changing this decision*

425. Our draft decision is not to change IM decision CC13 or the way it is implemented. Our reasons for not proposing to change this decision are discussed in Topic paper 4: Cost of capital issues.

**Existing cost of capital IM decision CC18**

<b>Decision CC18</b> <b>Corporate tax rate in WACC estimates – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>The corporate tax rate is 30% up until the end of the 2011 tax year, and 28% thereafter. Changes in the corporate tax rate will flow through to future post-tax WACC estimates automatically.</p> <p>See section 6.5, H10 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

*Why we do not propose changing this decision*

426. Our draft decision is not to change IM decision CC18 or the way it is implemented. Our reasons for not proposing to change this decision are discussed in Topic paper 4: Cost of capital issues.

**Existing cost of capital IM decision CC25**

<b>Decision CC25</b> <b>Corporate tax rate in WACC estimate – Airports</b>	<b>Original 2010 decision</b> The corporate tax rate is 30% up until the end of the 2011 tax year, and 28% thereafter. Changes in the corporate tax rate will flow through to future post-tax WACC estimates automatically.  See sections 6.5, E10 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

*Why we do not propose changing this decision*

427. Our draft decision is not to change IM decision CC25 or the way it is implemented. Our reasons for not proposing to change this decision are discussed in Topic paper 4: Cost of capital issues.

## Chapter 16: Gas pricing methodologies decisions we do not propose changing

428. Our draft decisions in respect of GP01, GP02, GP03, GP04 and GP05 are discussed together below.

### Existing gas pricing methodologies IM decision GP01

<b>Decision GP01</b> <b>Principles-based approach to gas pricing</b>	<b>Original 2010 decision</b> A 'principles-based' approach applies.  See section 7.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

### Existing gas pricing methodologies IM decision GP02

<b>Decision GP02</b> <b>Pricing principles to be consistent with Gas Authorisation</b>	<b>Original 2010 decision</b> The pricing principles are consistent with those adopted for the Gas Authorisation, with some minor modifications.  See section 7.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

### Existing gas pricing methodologies IM decision GP03

<b>Decision GP03</b> <b>Pricing principles in the IM are to be used to measure consistency under ID</b>	<b>Original 2010 decision</b> Under ID, where a GPB must disclose the extent of consistency of the pricing methodology it actually applies with the pricing principles, or the reasons for any inconsistency between its pricing methodology with the pricing principles, the relevant pricing principles are those set out in the pricing methodologies IM.  See section 7.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

### Existing gas pricing methodologies IM decision GP04

<b>Decision GP04</b> <b>No application of gas pricing IM to gas DPPs</b>	<b>Original 2010 decision</b> The IM does not apply to DPPs.  See section 7.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

### Existing gas pricing methodologies IM decision GP05

<b>Decision GP05</b> <b>Gas pricing IM may apply to a CPP</b>	<b>Original 2010 decision</b> The IM applies to CPPs, but only to a particular CPP applicant if (at the time of the supplier making its CPP application) the Commission's most recent summary and analysis (under ID) has identified that the IM will apply to that supplier.  See section 7.3, Appendix I of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

#### *Why we do not propose changing these decisions*

429. Our draft decision in respect of GP01, GP02, GP03, GP04 and GP05 is to make no change.
430. Both suppliers and consumers have raised concerns over the usefulness and application of the pricing principles to GTBs.<sup>102</sup>
431. We considered whether IM decisions GP01, GP02, GP03, GP04 and GP05 should be changed to:
- 431.1 remove the disclosure requirements which assess a GTB's performance against pricing principles; and
- 431.2 remove the ability to set pricing methodologies in a CPP determination.

<sup>102</sup> MDL, Untitled submission on the gas pipeline stakeholder meeting (28 January 2016), p. 3; MDL, Untitled submission on the problem definition paper (21 August 2015), p. 13; MGUG "IM review – Gas stakeholder meeting 8 December 2015" (28 January 2016), p. 3; Colonial, Untitled submission on the gas pipeline stakeholder meeting (29 January 2016), p. 4.

432. Having reviewed the IMs in light of the submissions, we do not propose making those changes because:
- 432.1 we consider that issues of pricing are being addressed by the proposed changes we are making to the form of control and by the Gas Industry Company (**GIC**) code convergence programme;
  - 432.2 we will be working with the GIC and stakeholders to assess the impacts of these changes and any new pricing mechanisms that suppliers introduce;
  - 432.3 there is benefit to stakeholders in maintaining the interim ability to assess performance of a GTB against the pricing principles while the codes are aligned and new pricing mechanisms are implemented; and
  - 432.4 having the current disclosure requirements in place will also provide stakeholders with a point of reference to raise their issues and allows the Commission, and the GIC, to address those matters as they arise.

## Chapter 17: Specification of price decisions we do not propose changing

### Existing specification of price IM decision SP08

<b>Decision SP08</b> <b>Price specified by revenue cap – Transpower</b>	<b>Original 2010 decision</b> Price for Transpower will be specified by a total revenue cap.  See section 7.3 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

#### *Why we do not propose changing this decision*

433. Our draft decision is not to change IM decision SP08 or the way it is implemented. We go on to discuss two issues we considered in respect of this existing decision, but that did not lead us to propose a change to the IMs. These concerned:

433.1 Transpower’s exposure to inflation risk; and

433.2 Transpower’s suggestion that we automate the MAR update process.

#### Transpower inflation risk

434. In Topic paper 1: Form of control and RAB indexation, we proposed a possible change to protect both consumers and Transpower from inflation risks by delivering real financial capital maintenance on an ex-post basis. Having further considered the implementation of this proposed change, we no longer propose to change the IMs in response to this issue. We are now of the view that this change would be better made by expanding the existing revenue wash-up mechanisms in the IPP Determination for the 2020–2025 regulatory control period (**RCP3**). This would mean that all specified wash-ups would remain contained within the IPP (as opposed to being split across IMs and IPP).

435. We anticipate that this might be achieved by including a ‘CPI wash-up adjustment’ in the wash-up of the forecast capital charge calculation in the IPP maximum allowable revenue (**MAR**) wash-up.<sup>103</sup> The resulting gain or loss amount from that wash-up would automatically end up in the EV account and would then be applied in Transpower’s prices through the EV adjustment in a following pricing year. We note that the EV adjustment process is already allowed for in the IMs.

<sup>103</sup> The MAR wash-up process is currently specified for RCP2 in clause 21.1 of the Transpower IPP Determination. The wash-up calculation details for this are set out in Schedule E of the IPP Determination. The EV adjustment that allows the wash-up amount to be applied to prices is then set out in clause 24.1 of the IPP Determination. To give effect to the proposed [change](#), Schedule E would be amended to include the CPI wash-up adjustment with the annual capital charge.

436. As noted in Topic paper 1, we have only considered the CPI wash-up as a possible solution. We are open to views from interested parties as to whether they consider the benefits of this change are likely to be sufficiently material to outweigh the compliance or other costs of doing so.

Automating the Transpower MAR update process

437. In reaching this draft decision, we also considered an implementation issue raised by Transpower regarding whether there are benefits in amending the IMs to allow us to automate the Transpower MAR update process. We committed to considering this when we made our most recent determination of Transpower’s price-quality path in 2014.<sup>104</sup>

438. We do not propose amending the Transpower IM Determination to automate the MAR update process at this time, as automating this process would remove our ability to scrutinise the underlying data used, and we consider that determining the forecast MAR has proven beneficial to consumers in the past.

439. We may revisit this in future if we become more comfortable with Transpower’s forecast MAR updates. If we do this, we would also need to consider the development of additional features into the IMs or in the compliance requirements of the IPP to enable us to reconsider the price-quality path if we later picked up information that suggested we should do so.

**Existing specification of price IM decision SP10**

<p><b>Decision SP10</b>  <b>Recoverable costs – Transpower</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Recoverable costs include instantaneous reserves availability charges (with some exclusions), the costs of developing and funding transmission alternatives under some conditions, and the net incremental carry forward amount under IRIS.</p> <p>See section 7.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>The amendment affects the IMs relating to the individual price-quality regulation of Transpower. It will apply immediately, with the practical effect of allowing recoverable costs to be calculated in this way from the first disclosure year for RCP2.</p>
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<sup>104</sup> Commerce Commission “Setting Transpower’s individual price-quality path for 2015-2020” (29 August 2014), para 3.29.

	<p>We have added a new recoverable cost to the specification of price IM to allow Transpower to recover operating costs that were originally forecast and approved as components of major capex projects.</p> <ul style="list-style-type: none"> <li>• The amendment caters for the situation where the expenditure forecast in respect of approved major capex projects is ultimately required to be accounted for under GAAP as opex (such as project feasibility costs).</li> </ul> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p> <p><b>2014 amendment to this decision (2)</b></p> <p>The addition of the new recoverable cost ensures that the overall framework established in respect of catastrophic events is appropriate, whereby Transpower should be:</p> <ul style="list-style-type: none"> <li>• compensated through the future amended IPP for prudent additional net costs that are forecast to be incurred after the price-quality path is reset (ie, existing reconsideration provisions);</li> <li>• cushioned through the future amended IPP against changes in future demand, by factoring in up-to-date forecasts when the price-quality path is reset (ie, existing reconsideration provisions); and</li> <li>• compensated through an amount in future revenues for prudent additional net costs of the catastrophic event incurred before the price-quality path is amended (ie, new recoverable cost).</li> </ul> <p>The amendment affects the IMs relating to individual price-quality regulation for Transpower.</p> <p>It will apply immediately, with the practical effect of allowing the recovery of prudent net additional opex following a catastrophic event occurring from the commencement of RCP2.</p> <p>The first pricing year in which the amendment may therefore be applied in the setting of Transpower’s transmission revenue under the transmission pricing methodology (<b>TPM</b>) is the pricing year commencing 1 April 2016.</p> <p>We have amended the specification of price IM to allow Transpower to recover, as a recoverable cost, prudent net additional opex incurred in the period between the date of a catastrophic event and the effective date of any resulting amended IPP arising from a reconsideration of the IPP.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Transpower</p>

*Why we do not propose changing this decision*

440. Our draft decision is not to change IM decision SP10 or the way it is implemented.

441. In June 2013 Transpower requested a series of IM changes, including a request for the Commission to:<sup>105</sup>

Amend the definition of “operating expenditure” in the IPP to exclude black start and over-frequency arming. Amend the definition of “pass-through costs” in the Transpower IM to include: ... Black start and over-frequency arming costs.

442. We consider that black start and over-frequency arming costs are currently part of the operating cost allowance set by the Commission for RCP2 (ie, the currently price-quality regulatory period applying to Transpower), and Transpower must therefore manage the risk of forecasting these costs within the overall pool of opex.

443. Based on the information provided we do not see a reason to consider that black start and over frequency costs are materially different to any other operating cost faced by Transpower. We therefore consider that the policy intent of the IM decision is being achieved.

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<sup>105</sup> Letter from Jeremy Cain (Transpower) to Dane Gunnell (Senior Analyst, Commerce Commission) regarding amendments to Transpower Input Methodologies for RCP2 (14 June 2013), p. 5. Available at: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/amendments-and-clarifications/>.

## Chapter 18: IRIS decisions we do not propose changing

### Existing IRIS IM decision IR01

<p><b>Decision IR01</b>  <b>IRIS to apply – EDBs</b>    <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>The Commission will implement an IRIS under a CPP. The efficiency gain or loss for a particular year will be calculated as the difference between actual and forecast controllable opex for the current year, minus the difference in the preceding year, the result of which provides the incremental gain/loss for that year.</p> <p>See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>The revised IRIS provides a time consistent incentive to control opex and, for DPPs, capex too.</p> <p>For opex, the retention period for savings and losses is 5 years following the year of the gain and loss, which is equivalent to a retention factor of around 35% for a supplier.</p> <p>We have provided a time consistent incentive for capex that is similar to the incentive on base capex for Transpower New Zealand. The IRIS introduced in 2010 for other suppliers did not apply to capex.</p> <p>Unlike the approach for opex, we specify the retention factor directly for capex, rather than specifying a retention period. In addition, the choice of retention factor will be decided at the time of each price-quality path reset.</p> <p><a href="#">Amendments to input methodologies for electricity distribution services and Transpower New Zealand: Incremental Rolling Incentive Scheme (27 November 2014)</a></p> <p><b>2015 amendment to this decision (2)</b></p> <p>As a CPP may be a response to unforeseen circumstances that have a significant impact on a supplier, we consider that some flexibility on the application of IRIS under different circumstances is required.</p> <p>We have introduced a clause to the determination that allows use of an alternative allowance of opex or capex for the purposes of calculating IRIS adjustments. We envisage this clause would be used in certain circumstances to ensure consistency across a CPP.</p> <p>The ENA noted that, under s 53X(2), we are able to advise the suppliers of different starting prices that apply following the expiry of a CPP. It is possible that these prices may not have an underlying opex forecast from which to calculate IRIS carry over amounts.</p>
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We have addressed this issue through an update to the determination. Under the new clause, at the expiration of the CPP, the Commission will notify the party of the forecast opex and forecast value of commissioned assets to use for the purpose of calculating the IRIS carry over amounts.

To give effect to the IRIS in all situations we have introduced a number of additional adjustment terms to the IMs that apply under different scenarios.

We have identified six generic scenarios that may occur under default/customised price-quality regulation. Under each of these scenarios suppliers will need to apply one or more of the proposed adjustment terms.

Table 5.2 (of the reasons paper) shows which adjustment terms need to be applied in each of the scenarios described above together with references to the clauses that apply in the accompanying determination:

	Scenario					
	1	2	3	4	5	6
Clause reference	3.3.4 (2) (a)	3.3.4 (2) (b)	3.3.4 (3)	3.3.4 (4)	3.3.4 (5)	3.3.4 (6)
Base year adjustment term	✓	✓	✓	✓	✓	
Baseline adjustment term			✓		✓	✓
Roll-over adjustment term		✓		✓		
One-year adjustment term 1				✓	✓	
One-year adjustment term 2				✓	✓	
One-year adjustment term 3				✓	✓	
One-year adjustment term 4						✓

	One-year adjustment term 5						✓
	One-year adjustment term 6						✓
	One-year adjustment term 7						✓
	One-year adjustment term 8						✓
	One-year adjustment term 9						✓
	<p>The baseline adjustment term is now defined separately for different scenarios. This gives effect to the revised (Powerco) approach when EDBs are transitioning onto a CPP:</p> <ul style="list-style-type: none"> <li>• Under Scenarios 3 and 5 it is defined under clause 3.3.7 (1) of the IMs; and</li> <li>• Under Scenario 6 it is defined under clause 3.3.7 (2) of the IMs.</li> </ul> <p><a href="#">Further amendments to input methodologies for electricity distributors subject to price-quality regulation - Incremental Rolling Incentive Scheme (IRIS) (25 November 2015)</a></p>						
<b>This original decision applies to (sector):</b>	EDBs						

*Why we do not propose changing this decision*

444. We do not propose changing IM decision IR01. However, there are two issues we considered in regard to this existing decision:

444.1 a potential error identified by Dr Lally; and

444.2 an issue with the roll-over adjustment term for single year DPPs.

### Potential error identified by Dr Lally

445. In his review of WACC issues, Dr Lally suggests that the IRIS mechanism's treatment of opex includes a 'design error':<sup>106</sup>

In summary, the Commission's approach to opex is consistent with the NPV = 0 principle but inflation forecasting errors arising from opex raise prices by more than the inflation shock because inflation forecasting errors are compensated for twice. This would appear to be a design error.

446. We agree that from a logical standpoint any disparity between the opex allowance and the actual opex that is due to CPI forecasting error should probably not be covered under IRIS, as it is fully compensated through our provision of a real return.
447. However, to implement Dr Lally's suggested approach to address this:
- 447.1 we would need to identify the relationship between the forecast CPI and the forecast opex input price forecast (eg, confirm whether a 1% error in CPI forecasts also means a 1% error in opex input price forecasts); and
- 447.2 if there is a relationship, estimate and eliminate the impact of the CPI forecast error from the out-turn of actual opex prior to making IRIS adjustments.
448. The additional complexity to implement this fix does not seem to outweigh the benefit of doing so, given the opex incentive rate is only an estimate in any case (ie, it is currently 34%, based on a 5-year retention of permanent savings, but this changes with the WACC).
449. We note that this conclusion is also relevant to our consideration of the Transpower IRIS under IM decision IR04 below.

### Issue with way that IRIS recoverable costs are calculated for single year DPPs

450. There is a potential issue with the way that IRIS recoverable costs are calculated when a CPP is followed by a DPP that has only one year of the DPP regulatory period remaining.
451. We have chosen not to make a change in response to this issue at this time. Based on our current understanding about the timing of potential CPP applications, we do not expect this issue to cause a problem for the foreseeable future. However, should we be made aware of a supplier that intends to submit a CPP application with an approval date targeted in 2019, then we will consider our options for making a targeted amendment.

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<sup>106</sup> Dr Lally's expert advice on the cost of debt, asset beta adjustments for GPBs, RAB indexation and inflation risk, and TAMRP "Review of further WACC issues" (report to the Commerce Commission, 22 May 2016), p. 40.

452. We also note that Orion will have one-year of the DPP regulatory period remaining once it transitions off its CPP. However, as confirmed in our recent paper on the Orion transition to the DPP,<sup>107</sup> the IMs establish that Orion does not need to calculate an opex or capex incentive amount for any year commencing on or prior to 1 April 2020.<sup>108</sup>

#### Existing IRIS IM decision IR04

<b>Decision IR04</b> <b>IRIS to apply under an IPP – Transpower</b>	<b>Original 2010 decision</b> <p>The Commission will implement an IRIS under an IPP. The efficiency gain or loss for a particular year will be calculated as the difference between actual and forecast controllable opex for the current year, minus the difference in the preceding year, the result of which provides the incremental gain/loss for that year.</p> <p>See section 7.5 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

#### *Why we do not propose changing this decision*

453. We have not completed our review of the Transpower IRIS IM and we are not yet in a position to reach a draft decision on whether to make any changes to it.
454. We acknowledge concerns raised by Transpower about the operation of its IRIS mechanism.<sup>109</sup> We intend doing further analysis to define whether Transpower’s concerns amount to a problem with the current scheme and whether any improvements might involve changes to the IM.
455. We aim to reach a final decision on any changes to the Transpower IRIS IM at the same time as the rest of the IM review (ie, December 2016). Prior to then, we will consult on a draft decision on whether to make changes to the Transpower IRIS. We will update interested parties on our timing for draft and final decisions on the Transpower IRIS IM in our anticipated September 2016 process update.

<sup>107</sup> Commerce Commission, “Orion’s transition to the 2015-2020 default price-quality path – Key considerations and possible approaches” (14 March 2016), para 39.

<sup>108</sup> *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26, as amended, clauses 3.3.2(3)(a) and 3.3.10.

<sup>109</sup> Transpower “Incremental rolling incentive scheme” (20 March 2015), available at: <http://www.comcom.govt.nz/dmsdocument/13059>; Transpower “Input methodologies: Scoping the statutory review” (31 March 2015).

**Existing IRIS IM decision IR06**

<b>Decision IR06</b> <b>Five-year retention of efficiency gains – Transpower</b>	<b>Original 2010 decision</b> The length of time Transpower is allowed to retain the efficiency gain is 5 years.  See section 7.5 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

*Why we do not propose changing this decision*

456. We have not yet completed our review of the Transpower IRIS IM and so we are not yet in a position to reach a draft decision on whether to make any changes to it. See IM decision IR04 above.

## **Part 3: IM decisions that we do not propose changing, and found no reason to consider changing**

### **Chapter 19: Introduction to Part 3**

457. This Part lists those existing IM decisions:

457.1 in light of our framework, submissions on the IM review so far, and all other relevant information before us, we found no reason to consider changing at this stage;<sup>110</sup> and

457.2 we therefore do not propose changing (either at a policy level, or in terms of the implementation of the policy decision) at this stage.

458. We remain open, however, to receiving submissions on all existing decisions, including the existing IM decisions listed in this Part of the report.

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<sup>110</sup> That is not to say there have never been any issues raised in respect of the existing IM decisions listed in this Part of the report. Minor issues have been raised in the past that are relevant to some of the existing IM decisions listed here; but none that, when we carried out our effectiveness review, we considered were sufficiently material to lead us to consider changing the IMs.

## Chapter 20: Decisions we do not propose changing, and found no reason to consider changing

### Cost Allocation IM decisions

<b>Decision CA01</b> <b>Allocating directly attributable cost</b>	<b>Original 2010 decision</b> <p>If a cost is solely and wholly caused by a single type of regulated service the cost is 'directly attributable' and is allocated solely to that type of service.</p> <p>See section 3.3 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>aThis decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision CA06</b> <b>Variation to three allocation approaches</b>	<b>Original 2010 decision</b> <p>Suppliers may also clarify their cost allocation policy more directly (than through the use of the three approaches) through their own operational practices. Where this is the case, the IM allows suppliers to make voluntary deductions for operating costs and asset values that have been recovered in arm's-length transactions.</p> <p>See sections 3.3, Appendix B, section B7 of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision CA07</b> <b>No cost allocation for common costs – Transpower</b>	<b>Original 2010 decision</b> <p>Transpower is not required to adjust the total costs associated with supplying electricity transmission services to take into account any costs that might be common to regulated and unregulated services.</p> <p>See section 3.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<p><b>Decision CA08</b>  <b>Operating costs must be adjusted for system operator costs – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>System operator services are defined under Part 4 as electricity line services.</p> <p>Operating costs or asset values allocated to activities undertaken by Transpower to supply electricity transmission services other than system operator services, must be net of costs or asset values implicitly or explicitly recoverable by Transpower in respect of any agreement between it and the Electricity Authority in respect of the system operator services.</p> <p>In addition, fixed assets used solely for the purposes of supplying system operator services are to be excluded from Transpower’s RAB. Any costs recovered through such an agreement are to be excluded from any opex or capex forecasts used to determine Transpower’s IPP.</p> <p>See section 3.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

<p><b>Decision CA09</b>  <b>Costs associated with new investment contracts – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>Services provided by New Investment Contracts (<b>NICs</b>) fall under the Part 4 definition of electricity lines services as it involves the conveyance of electricity by line.</p> <p>Fixed assets associated with NICs are to be excluded from Transpower’s RAB. Any capex included in NICs is to be excluded from any capex forecasts used to determine Transpower’s IPP.</p> <p>Transpower should continue to include all operating costs associated with NICs within its total operating costs associated with providing regulated services.</p> <p>See section 3.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

<b>Decision CA10</b> <b>Allocating directly attributable cost – Airports</b>	<b>Original 2010 decision</b> <p>If a cost is solely and wholly caused by a single activity the cost is ‘directly attributable’ and is allocated solely to that activity.</p> <p>See section 3.3 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

### Asset Valuation IM decisions

<b>Decision AV01</b> <b>Initial RAB values for EDBs and GPBs</b>	<b>Original 2010 decision</b> <p>EDBs and GPBs must establish their initial RAB values from existing regulatory valuations, namely:</p> <ul style="list-style-type: none"> <li>• the regulatory asset values disclosed in 2009 in accordance with applicable ID requirements; or</li> <li>• in the case of assets that are subject to the Gas Authorisation, the RAB values determined under the Gas Authorisation as at 30 June 2005, updated to the financial year ending in 2009 for capex, depreciation and CPI-indexation.</li> </ul> <p>See section 4.3 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<p><b>Decision AV02</b></p> <p><b>Adjustments to initial RAB values</b></p>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs to adjust their initial RAB values to:</p> <ul style="list-style-type: none"> <li>• correct for known errors in asset registers, with respect to the application of valuation approaches under existing ID requirements (with the exception of asset covered by the Gas Authorisation);</li> <li>• make adjustments to ensure that assets included in the initial RAB values align with the definitions of electricity lines services and gas pipeline services provided for in sections 54C and 55A of the Commerce Act;</li> <li>• in the case of EDBs: <ul style="list-style-type: none"> <li>○ adjust the application of multipliers in their 2004 optimised deprival value (<b>ODV</b>) valuations where better information has become available since 2004 (including revised ranges and application for some multipliers);</li> <li>○ reapply the optimisation and EV tests set out in the 2004 ODV Handbook, with respect to assets where an optimisation or EV adjustment in 2004 led to either a full or partial write-down;</li> <li>○ ensure finance during construction (<b>FDC</b>) costs are accounted for in establishing the initial RAB value of assets; and</li> </ul> </li> <li>• in the case of Vector’s NGC Distribution and NGC Transmission assets, adjust the value to provide for CPI indexation from the first day of the disclosure year 2006.</li> </ul> <p>See section 4.3, Appendix E, section E2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

<b>Decision AV06</b> <b>Commissioned assets added to RAB</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs should include capital additions in their RAB values at cost in the year in which the asset is 'commissioned', that is when the asset is first used by the regulated supplier to provide electricity distribution services/gas pipeline services. When a regulated supplier disposes of an asset the closing RAB value of that asset, for the disclosure year in which the disposal occurs, is nil.</p> <p>See section E4, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision AV07</b> <b>Network spares</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs should include network spares in the roll forward as additions to the RAB value where they are:</p> <ul style="list-style-type: none"> <li>• treated as the cost of an asset under GAAP (wholly or in part); and</li> <li>• held in appropriate quantities, considering the historical reliability of the equipment and the number of items installed on the network.</li> </ul> <p>See section E4, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision AV08</b> <b>Easement rights</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs must include new easement rights in the RAB value at cost in the year in which the rights are acquired, provided that the RAB value of new easement rights does not exceed fair market value, as determined by an independent valuer.</p> <p>See section E6, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<b>Decision AV10</b> <b>Vested assets</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs must include vested assets in the RAB value at the cost to the supplier, consistent with GAAP, provided that the RAB value does not exceed the amount of consideration paid by the regulated supplier in respect of the asset.</p> <p>See section E7, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<b>Decision AV11</b> <b>Lost and found assets</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs must remove assets recognised as lost from the RAB value in the year in which they are identified as lost, and must reduce the RAB value by the asset's opening RAB value in that year. Once the initial RAB value has been established, lost assets that were in the original RAB will be permitted to remain in the RAB value.</p> <p>Once the initial RAB value has been established found assets are limited to assets commissioned after the 2009 disclosure year.</p> <p>Regulated suppliers must add found assets to the RAB in the year in which they are found, and must establish the RAB value of found assets at cost, consistent with GAAP, where sufficient records exist.</p> <p>Where sufficient records do not exist, regulated suppliers may assign the asset the same value as a similar asset in the RAB (where such an asset exists). If no such similar asset exists, regulated suppliers must use the asset's market value as verified by an independent valuer.</p> <p>See section E9, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<p><b>Decision AV15</b> Revenues received on works under construction</p>	<p><b>Original 2010 decision</b></p> <p>When they commission works under construction EDBs and GPBs must reduce the cost of asset, established consistent with GAAP, by the amount of any revenue derived in relation to the assets while they were works under construction (where such a reduction is not already made under GAAP, and where the revenue has not already been reported as income under ID).</p> <p>See section E5, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

<p><b>Decision AV16</b> Straight line depreciation applies</p>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs must depreciate assets in their RAB using straight line depreciation.</p> <p>Regulated suppliers subject to default/customised price-quality regulation may apply to use an alternative depreciation approach under a CPP.</p> <p>Total (unallocated) depreciation over the lifetime of the asset must not exceed the value at which the asset is first recognised in the RAB under Part 4 (after adjusting for the effects of revaluations).</p> <p>Regulated suppliers may not depreciate land and easements (other than fixed life easements).</p> <p>See section E10, Appendix E of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

<b>Decision AV19</b> <b>Cost allocation applies to unallocated RAB</b>	<p><b>Original 2010 decision</b></p> <p>Regulated suppliers must record the total (ie, ‘unallocated’) value of an asset in the asset base and roll it forward (for depreciation, revaluations, additions etc.) on an unallocated basis. The cost allocation IM is applied to this asset value whenever it is necessary to determine a specifically attributable (ie, ‘allocated’) portion of the asset value for regulated activities (for example to calculate depreciation and revaluations).</p> <p>See section E13, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision AV20</b> <b>Initial RAB values – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Transpower must establish initial RAB values for its assets based on the values determined under the settlement agreement as at 30 June 2011.</p> <p>See section 4.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower
<b>Decision AV21</b> <b>Pseudo asset in initial RAB – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>The initial value of RAB should include the remaining value of the HVAC lines pseudo asset, established by the settlement agreement, as at 30 June 2011.</p> <p>See section 4.3, paragraphs 4.4.25- 4.4.30 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision AV22</b> <b>RAB exclusions –</b> <b>Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Transpower should exclude from its RAB value:</p> <ul style="list-style-type: none"> <li>• any assets not used to provide electricity transmission services;</li> <li>• any asset that is part of a works under construction;</li> <li>• working capital;</li> <li>• goodwill; and</li> <li>• easement land, that is land acquired for the purpose of creating an easement, and with the intention of on-selling the land.</li> </ul> <p>See section 4.3, paragraphs 4.4.31-4.4.48, 4.4.60-4.4.63, 4.4.58-4.4.59, 4.4.89-4.4.103 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower
<b>Decision AV23</b> <b>System operator</b> <b>assets excluded from</b> <b>RAB – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Assets associated with delivering an agreement between Transpower and the Electricity Authority in respect of the provision of system operator services are excluded from the RAB value as the result of applying the cost allocation methodology.</p> <p>See section 4.4, paragraphs 4.4.15- 4.4.24 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower
<b>Decision AV24</b> <b>New investment</b> <b>contract assets</b> <b>valued at zero -</b> <b>Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Assets provided under NICs are included in the RAB at zero value.</p> <p>See section 4.4, paragraphs 4.4.4-4.4.14 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<p><b>Decision AV27</b>  <b>Commissioned assets added to RAB – Transpower</b>    <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower should include capital additions in its RAB value at cost in the year in which the asset is ‘commissioned’, that is when the asset is first ‘used by Transpower to provide electricity transmission services’. In the case of (a) land that is not easement land, and (b) easements, whose acquisition has been approved under Part F of the Electricity Governance Rules (or under the capex IM once it comes into effect), ‘commissioned’ means ‘first acquired by Transpower’.</p> <p>See section 4.3, paragraphs 4.4.68-4.4.80 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>The amendment affects the IMs relating to ID regulation and individual price-quality regulation for Transpower. It will apply to land assets acquired from 1 July 2015, which corresponds to the commencement date of the first disclosure year for RCP2.</p> <p>We have amended the definition of ‘commissioned’ in the IMs to clarify that land which is base capex may enter Transpower’s RAB when acquired, as opposed to when it is first used to supply electricity lines services.</p> <p>Base capex is capex with a forecast cost of less than \$20 million or which relates to specified types of projects or programmes such as asset replacement or asset refurbishment.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Transpower</p>

<p><b>Decision AV28</b>  <b>Network spares – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>Where the cost of a network spare is treated as the cost of an asset under GAAP (wholly or in part), it may be added to the RAB value at the date on which it is ‘commissioned’.</p> <p>See section 4.3, paragraphs 4.4.68-4.4.80 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

<p><b>Decision AV30</b> <b>Easements –</b> <b>Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower may include easements in its RAB value at cost in the year in which the rights are acquired, provided that:</p> <ul style="list-style-type: none"> <li>• the investments have been approved under the grid investment test in Part F of the Electricity Governance Rules; and</li> <li>• where Transpower acquires land to create a new easement, the cost of the easement is limited to the sum of: <ul style="list-style-type: none"> <li>○ legal and administrative costs;</li> <li>○ the detrimental impact on the value of the land, as determined by a valuer; and</li> <li>○ the cost of holding the land, calculated as the financing cost on the purchase of the land from the date Transpower acquires the land until the date the easement is created.</li> </ul> </li> </ul> <p>See section 4.4, paragraphs 4.4.89 – 4.4.103 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

<p><b>Decision AV31</b> <b>Lost and found assets – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower must remove assets recognised as lost from its RAB value in the disclosure year in which they are identified as lost, and should reduce the RAB value by the opening RAB value of the asset in that year. Once the initial RAB value has been established, lost assets that were in the initial RAB will be permitted to remain in the RAB value.</p> <p>Found assets are limited to assets commissioned after the 2011 disclosure year. Transpower should add found assets to the RAB value in the year in which they are found, and must establish the RAB value of found assets at cost, consistent with GAAP, where sufficient records exist.</p> <p>Where sufficient records do not exist, Transpower may assign the asset the same value as a similar asset in the RAB (where such an asset exists). If no such similar asset exists, Transpower must use the asset’s market value at the time the found asset is added to the RAB value, as verified by an independent valuer.</p> <p>See section 4.4, paragraphs 4.4.85- 4.4.88 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

<p><b>Decision AV32</b> <b>Purchase of assets from regulated supplier or related party – Transpower</b>  <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Where Transpower purchases an asset from another regulated supplier it must add the asset to its RAB value at the asset's equivalent value in the RAB of the seller.</p> <p>Where Transpower purchases an asset from a related party (provided the related party is not itself a regulated supplier), it must add the asset to its RAB value at depreciated historic cost where documentation is available to support this.</p> <p>Where sufficient records do not exist to establish depreciated historic cost, it must use the asset’s market value as verified by an independent valuer. For this purpose a related party includes both:</p> <ul style="list-style-type: none"> <li>• business units of Transpower that supply services other than electricity transmission services; and</li> <li>• a party that under GAAP is considered a related party (including any party that has conducted business either directly or indirectly with the supplier in the current financial year).</li> </ul> <p>See section 4.4, paragraphs 4.4.81 – 4.4.84 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
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	<p><b>Amendment to this decision</b></p> <p>The amendment affects the IMs relating to ID regulation and individual price-quality regulation for Transpower. It will apply with effect from 1 July 2015 which corresponds to the commencement date of the first disclosure year for RCP2:</p> <p>We have amended the definition of ‘related party’ to exclude those parties that are related to Transpower solely by virtue of the Crown’s ownership of Transpower.</p> <p>The term ‘related party’ is used in a number of places in the IMs, such as determining the regulatory value of assets acquired by Transpower from a related party under clause 2.2.7(1).</p> <p>The current definition draws on the meaning of ‘related’ under GAAP which has the effect of including Transpower’s shareholder (the Crown), the arms of the Crown (eg, Government departments) and State-Owned Enterprises such as Meridian Energy.</p> <p>Limiting the definition so as to specifically exclude parties related to Transpower via the Crown is expected to reduce Transpower’s costs from complying with related party requirements, while still upholding the policy intent of the requirement.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<b>This original decision applies to (sector):</b>	Transpower
<p><b>Decision AV34</b></p> <p><b>Straight line depreciation applies – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower must depreciate assets in its RAB using straight line depreciation. It may not depreciate land and easements (other than fixed life easements).</p> <p>See section 4.4, paragraphs 4.4.104 – 4.4.108 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<p><b>Decision AV36</b>  <b>Stranded assets – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>In the case of stranded assets, Transpower may apply accelerated depreciation in the year in which the asset becomes stranded, where the Commission approves this in accordance with the IPP Determination.</p> <p>See section 4.4, paragraphs 4.4.130- 4.4.139 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>
<p><b>Decision AV37</b>  <b>Asset lives when asset is coming to end of life – Transpower</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>For the purposes of individual price-quality regulation, system fixed assets in service at the start of a period of individual price-quality regulation should be deemed to have a remaining physical asset life equal to the duration of the regulatory period.</p> <p>See section 4.4, paragraphs 4.4.140- 4.4.143 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>The amendment affects the IMs relating to ID regulation and individual price-quality regulation for Transpower. It will apply to depreciation calculated in respect of assets from 1 July 2015, which corresponds to the commencement date of the first disclosure year for RCP2.</p> <p>We have removed the requirement in the asset valuation IM to spread the regulatory depreciation allowance for assets that reach the end of their depreciable life, across the remainder of a regulatory control period.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Transpower</p>

<b>Decision AV38</b> <b>Cost allocation applies to unallocated RAB – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Transpower must record the total (ie, ‘unallocated’) value of an asset base and roll it forward (for depreciation, revaluations, additions etc) on an unallocated basis. The cost allocation IM is applied to this asset value whenever it is necessary to determine a specifically attributable (ie, ‘allocated’) portion of the asset value for regulated activities (for example to calculated depreciation and revaluations).</p> <p>See section 4.5, Chapter 3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower
<b>Decision AV39</b> <b>Initial RAB values for non-land assets – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports must establish the initial value of their non-land assets using existing regulatory valuations, specifically asset values as on the last day of the disclosure year 2009, and as disclosed in the 2009 disclosure financial statements.</p> <p>See section 4.3 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports
<b>Decision AV44</b> <b>Finance leases and intangible assets – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports may include in their RAB values finance leases and intangible assets provided that they are identifiable non-monetary assets that are not goodwill, consistent with the meanings under GAAP. Airports must establish the value of permitted intangible assets added to RAB value after the last day of the disclosure year 2009 using the cost model for recognition under GAAP.</p> <p>See section 4.3, Appendix C, section C5 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision AV45</b> <b>Commissioned assets added to RAB – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports should include capital additions in their RAB values at cost in the year in which the asset is ‘commissioned’, that is when the asset is first ‘used by the Airport to provide specified airport services other than excluded services’. When an Airport disposes of an asset the closing RAB value of that asset, for the disclosure year in which the disposal occurs, is nil.</p> <p>See section 4.3, Appendix C, section C6 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision AV46</b> <b>Purchase of assets from regulated supplier or related party – Airports</b>	<p><b>Original 2010 decision</b></p> <p>If an airport purchases an asset from another supplier of services regulated under Part 4, then it must add the asset to its RAB value at the asset's equivalent value in the RAB of the seller.</p> <p>Where an Airport purchases an asset from a related party (that does not supply services that are regulated under Part 4), it must add the asset to its RAB value at depreciated historic cost where documentation is available to support this.</p> <p>Where sufficient records do not exist to establish depreciated historic cost, the Airport must use the asset’s market value as verified by an independent valuer. The market value must be established using the MVAU approach in the case of land, and must not exceed the asset’s depreciated replacement cost for non-land assets. For this purpose a related party includes both:</p> <ul style="list-style-type: none"> <li>• business units of the Airport that supply services other than specified airport services; and</li> <li>• a party that under GAAP is considered a related party (including any party that has conducted business either directly or indirectly with the supplier in the current financial year).</li> </ul> <p>See section 4.3, Appendix C, section C7 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<p><b>Decision AV47</b>  <b>Lost and found assets – Airports</b></p>	<p><b>Original 2010 decision</b></p> <p>Airports must remove assets recognised as lost from their RAB values in the disclosure year in which they are identified as lost, and must reduce the RAB value by the asset's opening RAB value in that year. From the end of the 2012 disclosure year, lost assets that were in the initial RAB value will be permitted to remain in the RAB value.</p> <p>After the end of the 2012 disclosure year, airports may only add found assets to the RAB value that were commissioned after the 2009 disclosure year. Airports must add found assets to the RAB value in the year in which they are found, and must establish the RAB value of found assets at cost, consistent with GAAP, where sufficient records exist.</p> <p>Where sufficient records do not exist, the Airport may assign the asset the same value as a similar asset in the RAB (where such an asset exists). If no such similar asset exists, the Airport must use the asset's market value as verified by an independent valuer (in the case of land, the market value must be determined using Schedule A of the IM Determination).</p> <p>See Appendix C, section C8 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Airports</p>
<p><b>Decision AV49</b>  <b>Easement rights – Airports</b></p>	<p><b>Original 2010 decision</b></p> <p>All airports must include new easement rights in the RAB value at cost in the year in which the rights are acquired, provided that the RAB value of new easement rights does not exceed fair market value, as determined by an independent valuer.</p> <p>See Appendix C, section C10, of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Airports</p>
<p><b>Decision AV51</b>  <b>Asset lives and limit on unallocated depreciation – Airports</b></p>	<p><b>Original 2010 decision</b></p> <p>Airports may determine asset lives for airport assets. However, total (unallocated) depreciation over the lifetime of the asset must not exceed the value at which the asset is first recognised in the Airport's RAB value under Part 4 (after adjusting for the effects of revaluations).</p> <p>See Appendix C, section C11 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Airports</p>

<b>Decision AV52</b> <b>Stranded assets – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Where an asset is stranded or expected to become stranded, airports may adjust the asset life consistent with the requirements in respect of asset lives.</p> <p>See Appendix C, section C12 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision AV53</b> <b>Cost allocation applies to unallocated RAB – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports must record the total (ie, ‘unallocated’) value of an asset in the asset base and roll it forward (for depreciation, revaluations, additions etc) on an allocated basis. The cost allocation IM is applied to this asset value whenever it is necessary to determine a specifically attributable (ie, ‘allocated’) portion of the asset value for regulated activities (for example to calculated depreciation and revaluations).</p> <p>See Appendix C, section C14 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

### Treatment of Taxation IM decisions

<b>Decision TX03</b> <b>Tax losses ignored</b>	<p><b>Original 2010 decision</b></p> <p>Tax losses in the wider tax group must be ignored when estimating tax costs.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<b>Decision TX05</b> <b>Initial regulatory tax asset value</b>	<b>Original 2010 decision</b> <p>The initial regulatory tax asset value in 2009 (as at 31 March) should be the lesser of that recognised under tax rules for the relevant assets or share of assets used to supply electricity or gas distribution services, or the initial RAB value.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision TX06</b> <b>Initial deferred tax balance is zero – EDBs and GDBs</b>	<b>Original 2010 decision</b> <p>The initial deferred tax balance should be zero.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB
<b>Decision TX07</b> <b>Tax effect of discretionary discounts and rebates – EDBs</b>	<b>Original 2010 decision</b> <p>For EDBs only, discretionary discounts and customer rebates should be treated as a tax deductible expense, if allowed under tax legislation, but should not be treated as a cost for the purposes of disclosing or determining regulated revenue.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	EDBs
<b>Decision TX09</b> <b>Tax payable approach applies – GTBs</b>	<b>Original 2010 decision</b> <p>Tax cost must be estimated using a tax payable approach.</p> <p>See section 5.3 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	GTBs

<b>Decision TX10</b> <b>Tax payable approach applies – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Transpower's tax obligations should be estimated using a tax payable approach.</p> <p>See section 5.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision TX11</b> <b>Tax legislation and cost allocation to be applied – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>The cost allocation IM is to be applied, and tax legislation is to be applied (to the extent practicable and subject to other relevant provisions in the IMs) to calculate the regulatory taxable income.</p> <p>See section 5.3 paragraph 5.4.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision TX12</b> <b>Notional leverage for deductible debt interest – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Tax deductible debt interest should be calculated using a notional leverage that is consistent with the cost of capital IM.</p> <p>See paragraphs 5.4.4- 5.4.7 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision TX13</b> <b>Tax losses ignored – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Tax losses in Transpower's wider tax group should be ignored when estimating tax costs, and any tax losses generated in the supply of regulated services should be notionally carried forward to the following disclosure year.</p> <p>See paragraphs 5.4.9- 5.4.12 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision TX14</b> Regulatory tax asset value of asset acquired – Transpower	<p><b>Original 2010 decision</b></p> <p>The regulatory tax asset value of assets acquired from a supplier of another type of regulated service should remain unchanged in the event of an acquisition of assets used to supply services under Part 4.</p> <p>See paragraphs 5.4.13- 5.4.17 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision TX15</b> Initial regulatory tax asset value – Transpower	<p><b>Original 2010 decision</b></p> <p>The initial regulatory tax asset value should be the lesser of that recognised by Inland Revenue for the relevant assets or share of assets used by Transpower to supply regulated electricity line services, and the initial RAB value.</p> <p>See paragraphs 5.4.18- 5.4.20 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision TX16</b> Tax payable approach applies – Airports	<p><b>Original 2010 decision</b></p> <p>An Airport's tax obligations should be estimated using a 'tax payable' approach.</p> <p>See section 5.3 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision TX17</b> Tax legislation and cost allocation to be applied – Airports	<p><b>Original 2010 decision</b></p> <p>The cost allocation IM is to be applied, and tax legislation is to be applied (to the extent practicable and subject to the other relevant provisions in the IMs), to calculate the regulatory taxable income.</p> <p>See Appendix D, section D2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision TX18</b> <b>Notional leverage for deductible debt interest – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Tax deductible debt interest should be calculated using a notional leverage that is consistent with the cost of capital IM.</p> <p>See Appendix D, section D2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision TX19</b> <b>Tax losses ignored – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Tax losses in an Airport’s wider tax group should be ignored when estimating tax costs, and any tax losses generated in the supply of airport services should be notionally carried forward to the following disclosure year.</p> <p>See Appendix D, section D2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision TX21</b> <b>Initial regulatory tax asset value – Airports</b>	<p><b>Original 2010 decision</b></p> <p>The initial regulatory tax asset value should be the lesser of that recognised by Inland Revenue for the relevant assets or share of assets used to supply airport services, and the initial RAB value.</p> <p>See Appendix D, section D2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

## Cost of Capital IM decisions

<p><b>Decision CC04</b> Vanilla WACC and post-tax WACC estimation methodology</p>	<p><b>Original 2010 decision</b></p> <p>The methodology for estimating a vanilla WACC is:</p> $\text{cost of debt} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>The methodology for estimating a post-tax WACC is:</p> $\text{cost of debt (after corporate tax)} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>See sections 6.7, H2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>
<p><b>Decision CC10</b> Date for determining price-quality path estimates of WACC – EDBs and Transpower (2014 decision)</p>	<p><b>Original 2014 decision</b></p> <p>We changed the date by which we must determine the estimates of WACC used for setting the DPP for EDBs and the IPP for Transpower New Zealand Limited from 30 September to 31 October for 2014. We have done this by changing:</p> <ul style="list-style-type: none"> <li>• the date by which we estimate the WACC percentile for electricity lines businesses; and</li> <li>• the dates by which inputs to the WACC percentile (the risk-free rate, debt premium, and the standard error of the debt premium and mid-point estimates of WACC) are determined or estimated.</li> </ul> <p><a href="#">Amendment to the WACC determination date for electricity lines services, including Transpower: Reasons paper (29 September 2014)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDBs/Transpower</p>

<p><b>Decision CC11</b>  <b>Cost of capital defined as estimate of WACC – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>The cost of capital is an estimate of the WACC which reflects the cost of debt and the cost of equity used to fund investment. The WACC will apply in respect of the supply of regulated services by Transpower.</p> <p>The Commission has compared the estimated WACC outputs against a range of other financial and economic information in order to check that commercially realistic estimates of WACC for EDBs and Transpower will be produced by the IM. See section 6.1, 6.8, H1, H2, H13 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><a href="#">Input Methodologies (Transpower) Supplementary Reasons Paper for Leverage in Cost of Capital (29 June 2012)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>
<p><b>Decision CC14</b>  <b>Vanilla WACC and post-tax WACC estimation methodology – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>The methodology for estimating a vanilla WACC is:</p> $\text{cost of debt} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>The methodology for estimating a post-tax WACC is:</p> $\text{cost of debt (after corporate tax)} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>See sections 6.7, H2 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

<p><b>Decision CC21</b> Vanilla WACC and post-tax WACC estimation methodology – Airports</p>	<p><b>Original 2010 decision</b></p> <p>The methodology for estimating a vanilla WACC is:</p> $\text{cost of debt} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>The methodology for estimating a post-tax WACC is:</p> $\text{cost of debt (after corporate tax)} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>See section 6.7, E2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Airports</p>
<p><b>Decision CC26</b> Commercially realistic estimates of WACC – Airports</p>	<p><b>Original 2010 decision</b></p> <p>The Commission has compared the expected WACC outputs under the IM against a range of other financial and economic information in order to check that the application of the cost of capital IM produces commercially realistic estimates of WACC for airports.</p> <p>See sections 6.8, E13 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Airports</p>
<p><b>Decision CC27</b> Term credit spread differential allowance may not be less than zero for a DPP  (2012 decision)</p>	<p><b>Original 2012 decision</b></p> <p>The TCSD should be set to a nil value if it would otherwise be negative.</p> <p>In 2012 we amended the TCSD allowance component of the cost of capital IM that applies to DPPs. This amendment sets out how we forecast a TCSD allowance during the regulatory period.</p> <p>See p. 25 and Attachment B of the 2012 reasons paper:</p> <p><a href="#">Specification and Amendment of Input Methodologies as Applicable to Default Price-Quality Paths: Reasons paper (28 September 2012)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>
<p><b>This decision applies to (instruments):</b></p>	<p>DPPs</p>

### Gas Pricing Methodologies IM decisions

<p><b>Decision GP06</b> Commission may amend a CPP gas pricing methodology annually</p>	<p><b>Original 2010 decision</b></p> <p>The Commission may amend a pricing methodology a maximum of once per year during the regulatory period. It may only do so where a GPB is proposing to make a material change to the pricing methodology specified in the CPP determination.</p> <p>See section 7.3, Appendix I of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>GDB/GTB</p>

### Specification of Price IM decisions

<p><b>Decision SP09</b> Pass-through costs – Transpower</p>	<p><b>Original 2010 decision</b></p> <p>The IM includes a list of pass-through costs and a process for adding new pass-through costs.</p> <p>The list of path-through costs includes local authority rates and regulatory levies.</p> <p>See section 7.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Transpower</p>

<p><b>Decision SP11</b>  <b>Recoverable cost for additional revenue – Alpine/Top Energy/Centralines</b>   <b>(2014 decision)</b></p>	<p><b>Original 2014 decision</b></p> <p>This amendment introduces a recoverable cost to allow for a one-off recovery of additional revenue for three EDBs (Alpine Energy, Top Energy and Centralines).</p> <p>This amendment addresses the impact of the limit to price increases for Alpine Energy, Top Energy and Centralines in the last 2 years of the current regulatory period (1 April 2013 – 31 March 2015).</p> <p>The amendment changes the definitions in the general provisions of the IMs, and the IMs that apply for the specification of price for both DPPs and CPPs.</p> <p>It will apply from 1 April 2015, which corresponds to the start of the next DPP regulatory period:</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>EDBs (Alpine Energy, Top Energy and Centralines only)</p>

### Amalgamation IM decisions

<p><b>Decision AM01</b>  <b>No price reset following amalgamation</b></p>	<p><b>Original 2010 decision</b></p> <p>The primary purpose of the IM covering amalgamations during a regulatory period is to provide certainty to suppliers that the Commission will not reset their prices until the end of the DPP or CPP regulatory period in which the transaction occurs. It is also intended to provide certainty as to when two (or more) price-quality paths should be amalgamated following a transaction.</p> <p>See section 8.6, paragraph 8.6.1 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

<b>Decision AM02</b> <b>Suppliers to aggregate price-quality paths on amalgamation</b>	<p><b>Original 2010 decision</b></p> <p>If a supplier amalgamates with another supplier of the same type of regulated service, the Commission will not reconsider the existing price-quality path but will require the suppliers involved in the amalgamation to aggregate price-quality paths for compliance purposes from the start of the disclosure year following the amalgamation (if both regulated suppliers are subject to a DPP) or at the expiry of a CPP (if one or more of the regulated suppliers are subject to a CPP).</p> <p>See section 8.6, 8.6.2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<b>Decision AM03</b> <b>Amalgamation rule for existing CPPs</b>	<p><b>Original 2010 decision</b></p> <p>Where one or more parties to the amalgamation are already subject to a CPP at the time of the amalgamation, a joint CPP may not apply to the amalgamated supplier until the supplier(s) on a CPP have each completed at least 3 years of their CPP regulatory period (where applicable) by the time the new CPP is to take effect. In this circumstance, the regulatory period of any existing CPP would be shortened from 4 or 5 years to 3 or 4 years (terminating on the day before the new CPP will apply).</p> <p>The change would be given effect through an amendment to the existing regulatory period(s) specified in the relevant s 52P determinations. A supplier must complete at least 3 years of its CPP because of the requirement in s 53W(2) that:</p> <p style="padding-left: 40px;">the Commission may set a shorter period than 5 years if it considers this would better meet the purpose of this Part, but in any event may not set a term less than 3 years.</p> <p>See section 8.6, 8.6.3 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

## IRIS IM decisions

<b>Decision IR03</b> <b>Five-year retention of efficiency gains</b>	<b>Original 2010 decision</b> <p>The length of time suppliers are allowed to retain the efficiency gain is 5 years.</p> <p>See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	EDBs
<b>Decision IR07</b> <b>RCP1 IRIS transition – Transpower</b>	<b>Original 2010 decision</b> <p>In the first year of RCP1 no IRIS will be implemented.</p> <p>See section 7.5 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

## Other regulatory rules and processes IM decisions

<p><b>Decision RR01</b> Treatment of periods that are not 12-month periods – DPP</p>	<p><b>Original 2012 decision</b></p> <p>Where the start or end date of any disclosure year is not aligned with the start or end date of a DPP regulatory period, the Commission may apply the input methodologies modified to the extent necessary to account for the change in length of the disclosure year.</p> <p>See p. 25 of the 2012 reasons paper:</p> <p><a href="#">Specification and Amendment of Input Methodologies as Applicable to Default Price-Quality Paths - Reasons Paper (28 September 2012)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

<p><b>Decision RR02</b> Availability of Information – DPP</p>	<p><b>Original 2012 decision</b></p> <p>Where information necessary to calculate any base year or disclosure year amounts has not been disclosed by the supplier, in setting a DPP the Commission may rely either on information disclosed under an ID Determination, prior ID requirements, or information obtained under a s 53ZD request.</p> <p>See para 72.2 of the 2012 reasons paper:</p> <p><a href="#">Specification and Amendment of Input Methodologies as Applicable to Default Price-Quality Paths - Reasons Paper (28 September 2012)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

## Attachment A: Index of existing decisions

### Purpose of this attachment

459. The purpose of this attachment is to assist readers in navigating this report. It does so by:

459.1 listing all existing decisions in order according to their unique code; and

459.2 indicating whereabouts each existing decision is located in this report.

### General provisions

Decision	Short title	Applies to (sectors)	Where located in this Report
GE01 (new)	General provisions (next closest alternative)	EDB/GPB/GDB/Transpower/Airports	Part 1

### Cost allocation

Decision	Short title	Applies to (sectors)	Where located in this Report
CA01	Allocating directly attributable cost	EDB/GDB/GTB	Part 3
CA02	Allocating not directly attributable cost	EDB/GDB/GTB	Part 2
CA03	Process for deciding allocation approach	EDB/GDB/GTB	Part 1
CA04	ABAA causal relationship approach and proxy allocators	EDB/GDB/GTB	Part 1
CA05	Definition of causal relationships	EDB/GDB/GTB	Part 2
CA06	Variation to three allocation approaches	EDB/GDB/GTB	Part 3
CA07	No cost allocation for common costs – Transpower	Transpower	Part 3
CA08	Operating costs must be adjusted for system operator costs – Transpower	Transpower	Part 3

CA09	Costs associated with new investment contracts – Transpower	Transpower	Part 3
CA10	Allocating directly attributable cost – Airports	Airports	Part 3
CA11	Allocating not directly attributable cost – Airports	Airports	Part 2
CA12	Causal relationship approach and proxy allocators – Airports	Airports	Part 1

### Asset valuation

Decision	Short title	Applies to (sectors)	Where located in this Report
AV01	Initial RAB values for EDBs and GPBs	EDB/GDB/GTB	Part 3
AV02	Adjustments to initial RAB values	EDB/GDB/GTB	Part 3
AV03	RAB roll forward with indexation	EDB/GDB/GTB	Part 2
AV04	RAB exclusions	EDB/GDB/GTB	Part 2
AV05	Finance leases and intangible assets	EDB/GDB/GTB	Part 1
AV06	Commissioned assets added to RAB	EDB/GDB/GTB	Part 3
AV07	Network spares	EDB/GDB/GTB	Part 3
AV08	Easement rights	EDB/GDB/GTB	Part 3
AV09	Capital contributions	EDB/GDB/GTB	Part 1
AV10	Vested assets	EDB/GDB/GTB	Part 3
AV11	Lost and found assets	EDB/GDB/GTB	Part 3
AV12	Assets purchased from regulated supplier	EDB/GDB/GTB	Part 1
AV13	Financing costs on works under construction – excludes exempt EDBs	EDB/GDB/GTB	Part 1

AV14	Financing costs on works under construction – exempt EDBs	Exempt EDBs	Part 1
AV15	Revenues received on works under construction	EDB/GDB/GTB	Part 3
AV16	Straight line depreciation applies	EDB/GDB/GTB	Part 3
AV17	Standard asset lives apply – with listed exceptions	EDB/GDB/GTB	Part 1
AV18	Assets retained in RAB for ID	EDB/GDB/GTB	Part 2
AV19	Cost allocation applies to unallocated RAB	EDB/GDB/GTB	Part 3
AV20	Initial RAB values – Transpower	Transpower	Part 3
AV21	Pseudo asset in initial RAB – Transpower	Transpower	Part 3
AV22	RAB exclusions – Transpower	Transpower	Part 3
AV23	System operator assets excluded from RAB – Transpower	Transpower	Part 3
AV24	New investment contract assets valued at zero – Transpower	Transpower	Part 3
AV25	Finance leases and intangible assets – Transpower	Transpower	Part 1
AV26	No indexation of RAB – Transpower	Transpower	Part 2
AV27	Commissioned assets added to RAB – Transpower	Transpower	Part 3
AV28	Network spares – Transpower	Transpower	Part 3
AV29	Asset disposals – Transpower	Transpower	Part 2
AV30	Easements – Transpower	Transpower	Part 3
AV31	Lost and found assets – Transpower	Transpower	Part 3

AV32	Purchase of assets from regulated supplier or related party – Transpower	Transpower	Part 3
AV33	Financing costs on works under construction – Transpower	Transpower	Part 1
AV34	Straight line depreciation applies – Transpower	Transpower	Part 3
AV35	Standard physical asset lives to apply with exceptions – Transpower	Transpower	Part 1
AV36	Stranded assets – Transpower	Transpower	Part 3
AV37	Asset lives when asset is coming to end of life – Transpower	Transpower	Part 3
AV38	Cost allocation applies to unallocated RAB – Transpower	Transpower	Part 3
AV39	Initial RAB values for non-land assets – Airports	Airports	Part 3
AV40	RAB roll forward with indexation – Airports	Airports	Part 1
AV41	Initial RAB values for land assets and revaluation approach – Airports	Airports	Part 1
AV42	RAB exclusions – Airports	Airports	Part 1
AV43	Financing costs on works under construction – Airports	Airports	Part 2
AV44	Finance leases and intangible assets – Airports	Airports	Part 3
AV45	Commissioned assets added to RAB – Airports	Airports	Part 3
AV46	Purchase of assets from regulated supplier or related party – Airports	Airports	Part 3

AV47	Lost and found assets – Airports	Airports	Part 3
AV48	Capital contributions and vested assets – Airports	Airports	Part 1
AV49	Easement rights – Airports	Airports	Part 3
AV50	Straight line depreciation applies with election to use non-standard approach – Airports	Airports	Part 1
AV51	Asset lives and limit on unallocated depreciation – Airports	Airports	Part 3
AV52	Stranded assets – Airports	Airports	Part 3
AV53	Cost allocation applies to unallocated RAB – Airports	Airports	Part 3
AV54	Initial RAB value – Powerco GDB	GDBs (Powerco only)	Part 2
AV55 (new)	Giving effect to IM decisions – applying alternative methodologies with equivalent effect – Airports	Airports	Part 1

### Treatment of taxation

Decision	Short title	Applies to (sectors)	Where located in this Report
TX01	Modified deferred tax approach applies – EDBs and GDBs	EDB/GDB	Part 1
TX02	Tax legislation and cost allocation to be applied – EDBs	EDBs	Part 2
TX03	Tax losses ignored	EDB/GDB/GTB	Part 3
TX04	Regulatory tax asset value of asset acquired	EDB/GDB/GTB	Part 1
TX05	Initial regulatory tax asset value	EDB/GDB/GTB	Part 3

TX06	Initial deferred tax balance is zero – EDBs and GDBs	EDB/GDB	Part 3
TX07	Tax effect of discretionary discounts and rebates – EDBs	EDBs	Part 3
TX08	Tax legislation and cost allocation to be applied – GDBs and GTBs	GDB/GTB	Part 1
TX09	Tax payable approach applies – GTBs	GTBs	Part 3
TX10	Tax payable approach applies – Transpower	Transpower	Part 3
TX11	Tax legislation and cost allocation to be applied – Transpower	Transpower	Part 3
TX12	Notional leverage for deductible debt interest – Transpower	Transpower	Part 3
TX13	Tax losses ignored – Transpower	Transpower	Part 3
TX14	Regulatory tax asset value of asset acquired – Transpower	Transpower	Part 3
TX15	Initial regulatory tax asset value – Transpower	Transpower	Part 3
TX16	Tax payable approach applies – Airports	Airports	Part 3
TX17	Tax legislation and cost allocation to be applied – Airports	Airports	Part 3
TX18	Notional leverage for deductible debt interest – Airports	Airports	Part 3
TX19	Tax losses ignored – Airports	Airports	Part 3
TX20	Regulatory tax asset value of asset acquired from another supplier- Airports	Airports	Part 1
TX21	Initial regulatory tax asset value – Airports	Airports	Part 3

**Cost of capital**

<b>Decision</b>	<b>Short title</b>	<b>Applies to (sectors)</b>	<b>Where located in this Report</b>
CC01	Cost of capital defined as estimate of WACC	EDB/GDB/GTB	Part 2
CC02	WACC percentile	EDB/GDB/GTB	Part 2
CC03	Commission to publish annual WACC estimates	EDB/GDB/GTB	Part 1
CC04	Vanilla WACC and post-tax WACC estimation methodology	EDB/GDB/GTB	Part 3
CC05	Cost of debt in WACC estimates	EDB/GDB/GTB	Part 1
CC06	Term credit spread differential allowance may apply	EDB/GDB/GTB	Part 1
CC07	Cost of equity in WACC estimates	EDB/GDB/GTB	Part 1
CC08	Corporate tax rate in WACC estimates	EDB/GDB/GTB	Part 2
CC09	Commercially realistic estimates of WACC	EDB/GDB/GTB	Part 2
CC10	Date for determining price-quality path estimates of WACC – EDBs and Transpower	EDBs/Transpower	Part 3
CC11	Cost of capital defined as estimate of WACC – Transpower	Transpower	Part 3
CC12	WACC percentile – Transpower	Transpower	Part 2
CC13	Commission to publish annual WACC estimates – Transpower	Transpower	Part 2
CC14	Vanilla WACC and post-tax WACC estimation methodology – Transpower	Transpower	Part 3

CC15	Cost of debt in WACC estimates – Transpower	Transpower	Part 1
CC16	Term credit spread differential allowance may apply – Transpower	Transpower	Part 1
CC17	Cost of equity in WACC estimates – Transpower	Transpower	Part 1
CC18	Corporate tax rate in WACC estimates – Transpower	Transpower	Part 2
CC19	Cost of capital defined as estimate of WACC – Airports	Airports	Part 1
CC20	Commission to publish annual WACC estimates – Airports	Airports	Part 1
CC21	Vanilla WACC and post-tax WACC estimation methodology – Airports	Airports	Part 3
CC22	Cost of debt in WACC estimates – Airports	Airports	Part 1
CC23	Term credit spread differential allowance may apply – Airports	Airports	Part 1
CC24	Cost of equity in WACC estimates – Airports	Airports	Part 1
CC25	Corporate tax rate in WACC estimate – Airports	Airports	Part 2
CC26	Commercially realistic estimates of WACC – Airports	Airports	Part 3
CC27	Term credit spread differential allowance may not be less than zero for a DPP	Airports	Part 3

### Gas pricing methodologies

Decision	Short title	Applies to (sectors)	Where located in this Report
GP01	Principles-based approach to gas pricing	GDB/GTB	Part 2
GP02	Pricing principles to be consistent with Gas Authorisation	GDB/GTB	Part 2
GP03	Pricing principles in the IM are to be used to measure consistency under ID	GDB/GTB	Part 2
GP04	No application of gas pricing IM to gas DPPs	GDB/GTB	Part 2
GP05	Gas pricing IM may apply to a CPP	GDB/GTB	Part 2
GP06	Commission may amend a CPP gas pricing methodology annually	GDB/GTB	Part 3

### Specification of price

Decision	Short title	Applies to (sectors)	Where located in this Report
SP01	Weighted average price cap applies – EDBs and GDBs	EDB/GDB	Part 1
SP02	Weighted average price cap or total revenue cap applies – GTBs	GTBs	Part 1
SP03	Pass-through costs – EDBs and GDBs	EDB/GDB	Part 1
SP04	Pass-through costs – GTBs	GTBs	Part 1
SP05	Recoverable costs – EDBs	EDBs	Part 1
SP06	Recoverable costs – GDBs	GDBs	Part 1
SP07	Recoverable costs – GTBs	GTBs	Part 1
SP08	Price specified by revenue cap – Transpower	Transpower	Part 2

SP09	Pass-through costs – Transpower	Transpower	Part 3
SP10	Recoverable costs – Transpower	Transpower	Part 2
SP11	Recoverable cost for additional revenue – Alpine/Top Energy/Centralines	EDBs (Alpine Energy, Top Energy and Centralines only)	Part 3

### Reconsideration of the price-quality path

Decision	Short title	Applies to (sectors)	Where located in this Report
RP01	Reconsideration of DPP	EDB/GDB/GTB	Part 1
RP02	Reconsideration of CPP	EDB/GDB/GTB	Part 1
RP03	Meaning of ‘material’ for purposes of reconsideration	EDB/GDB/GTB	Part 1
RP04	Reconsideration for contingent or unforeseen expenditure under a CPP – GTBs	GTBs	Part 1
RP05	Reconsideration of IPP – Transpower	Transpower	Part 1
RP06	Meaning of ‘material’ for purposes of reconsideration – Transpower	Transpower	Part 1
RP07	Annual reconsideration for effect of major capex and listed projects – Transpower	Transpower	Part 1

## Amalgamations

Decision	Short title	Applies to (sectors)	Where located in this Report
AM01	No price reset following amalgamation	EDB/GDB/GTB	Part 3
AM02	Suppliers to aggregate price-quality paths on amalgamation	EDB/GDB/GTB	Part 3
AM03	Amalgamation rule for existing CPPs	EDB/GDB/GTB	Part 3

## IRIS

Decision	Short title	Applies to (sectors)	Where located in this Report
IR01	IRIS to apply – EDBs	EDBs	Part 2
IR02	Treatment of IRIS balances – EDBs	EDBs	Part 1
IR03	Five-year retention of efficiency gains	EDBs	Part 3
IR04	IRIS to apply under an IPP – Transpower	Transpower	Part 2
IR05	Treatment of IRIS balances – Transpower	Transpower	Part 1
IR06	Five-year retention of efficiency gains – Transpower	Transpower	Part 2
IR07	RCP1 IRIS transition – Transpower	Transpower	Part 3
IR08	IRIS to apply under a CPP – GDBs and GTBs	GDB/GTB	Part 1
IR09	Treatment of IRIS balances – GDBs and GTBs	GDB/GTB	Part 1
IR10	Five-year retention of efficiency gains	GDB/GTB	Part 1

**Other regulatory rules and processes IM decisions**

Decision	Short title	Applies to (sectors)	Where located in this Report
RR01	Treatment of periods that are not 12-month periods – DPP	EDB/GDB/GTB	Part 3
RR02	Availability of Information – DPP	EDB/GDB/GTB	Part 3

**CPP (all these decisions are discussed in Topic paper 2: CPP requirements)**

Decision	Short title
CP01	Price path information
CP02	Expenditure information – qualitative
CP03	Expenditure information – quantitative
CP04	Period of information required
CP05	Detail on material projects and programmes
CP06	Information relevant to prices
CP07	Verification report
CP08	Audit and assurance report
CP09	Consumer consultation evidence
CP10	Certification
CP11	Modification or exemption of CPP application requirements
CP12	Information regarding quality
CP13	Cost allocation information
CP14	Asset valuation information
CP15	Tax information
CP16	Information relevant to alternative methodologies
CP17	Cost of capital information
CP18	Gas pricing methodology to be submitted with CPP proposal – GDBs and GTBs
CP19	General matters

CP20	Quality-only CPP
CP21	Verification requirements
CP22	Audit and assurance requirements
CP23	Consumer consultation requirements
CP24	Certification requirements
CP25	Reconsideration of a CPP
CP26	Modification or exemption of CPP application requirements
CP27	Evaluation criteria
CP28	Determination of annual allowable revenues
CP29	Cost allocation and asset valuation
CP30	Treatment of taxation
CP31	Cost of capital
CP32	Alternative methodologies with equivalent effect