Transpower Input Methodologies Determination

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

Date of Original Determination: 29 June 2012
Consolidating all amendments as of [Amendment Date] (a history of this determination, including all amendments, may be found over page)

Regulation Branch, Commerce Commission
Wellington, NEW ZEALAND

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### Determination version history

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Pursuant to Part 4 of the Commerce Act 1986 the Commerce Commission makes the following determination:
PART 1 GENERAL PROVISIONS

1.1.1 Title
This determination is the Transpower Input Methodologies Determination.

1.1.2 Application
(1) The input methodologies in this determination apply to electricity transmission services.
(2) The input methodologies in-
   (a) Part 2 apply in relation to information disclosure regulation under Subpart 4; and
   (b) Part 3 apply in relation to individual price-quality regulation under Subpart 7, of Part 4 of the Act.

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

1.1.4 Interpretation
(1) In this determination-
   (a) unless stated otherwise, references to Parts and Subparts are to named and numbered parts and subparts of the determination;
   (b) references to Subparts are to subparts within the same part in which the reference is made;
   (c) unless the context otherwise requires, a word which denotes the singular also denotes the plural and vice versa; and
   (d) unless stated otherwise, any reference to an allowance, amount, cost, sum or value is a reference to an allowance, amount, cost, sum or value calculated in relation to Transpower in respect of a disclosure year.
(2) In this determination, including in the schedule, the words or phrases in bold type bear the following meanings:

   75th percentile estimate of WACC means estimate, made in accordance with clause 2.4.7(3)(b)(i) and published pursuant to clause 2.4.8, of the 75th percentile for the post-tax mid-point estimate of WACC;

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

   A

   Act means the Commerce Act 1986;
actual controllable opex means, in relation to a disclosure year, the amount of operating expenditure made by Transpower in the categories to which allowed controllable opex relates;

allowed controllable opex means the allowance specified in an IPP determination for operating expenditure in categories specified as controllable;

auditor means-

(a) whilst Transpower is a public entity (as defined in s 4 of the Public Audit Act 2001), the Auditor-General; and
(b) where paragraph (a) does not apply, a person who is-
   (i) qualified for appointment as an auditor of a company under the Companies Act 1993; and
   (ii) independent;

base capex allowance has the same meaning as defined in the Capex IM;

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

cap has the same meaning as defined in the Capex IM;

Capex IM means the Transpower Capital Expenditure Input Methodology [2012] NZCC 2;

capital expenditure, means costs that-

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

catastrophic event has the meaning specified in clause 3.7.1;

change event has the meaning specified in clause 3.7.2;

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

(a) Part 2, clause 2.2.3(4); and
(b) Part 3, clause 2.2.3(4) as modified pursuant to clause 3.3.1;

collar has the same meaning as defined in the Capex IM;

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

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

(a) land that is not easement land; or
(b) an easement;
whose acquisition was approved by the-

(c) Electricity Commission under Part F of the Electricity Governance Rules 2003;
(d) Commission under s 54R(3)(b) of the Act; or
(e) Commission in accordance with any input methodology determined pursuant to s 54S of the Act;

'commissioned' means acquired by Transpower,
and 'commission' shall be construed accordingly;

commissioning date means the date that an asset is first commissioned;
corporate tax rate means the rate of income taxation applying to companies as specified in the tax rules;
cost of debt means the amount specified for \( r_d \) in clause 2.4.1(4);
cost of executing an interest rate swap has the meaning specified in clause 2.4.9(2);

D

debt premium has the meaning specified in and is the amount determined in accordance with, for the purpose of-
(a) Part 2, clause 2.4.4; and
(b) Part 3, clause 3.5.4;

depreciation, in relation to a disclosure year, means the allowance for that disclosure year to account for the diminution in an asset's remaining service life potential in the disclosure year in question determined in accordance with clause 2.2.4;
disclosure year means 12 month period ending on 30 June;
Example: 'disclosure year 2012' means 12 month period ending on 30 June 2012;
disposed asset means an asset that, in the disclosure year in question, has been sold or transferred, or has been irrecoverably removed from the Transpower's possession without consent, but is not a lost asset;
document has the same meaning as defined in s 2 of the Act;

E

easement means a right to use but not possess land belonging to another person or a right to prevent certain uses of another person's land;
easement land means land acquired with the intention of-
(a) creating an easement in respect of it; and
(b) disposing of the land thereafter;

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

Electricity Authority means the authority established under s 12 of the Electricity Industry Act 2010;

Electricity Commission means the same body as the Electricity Governance Board established under s 172M of the Electricity Act 1992 as in force immediately before its substitution by s 14 of the Electricity Amendment Act 2004;

electricity transmission services means electricity lines services (as 'electricity lines services' is defined in s 54C of the Act) supplied by Transpower;

engineer means an individual who is-

(a) a chartered professional engineer as defined in s 6 of the Chartered Professional Engineers Act 2002;
(b) acting in that professional capacity; and
(c) independent;

error has the meaning specified in clause 3.7.3;

excluded asset means an asset that is-

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

finance lease has the same meaning as under GAAP;

fixed life easement means an easement that-

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

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

found asset has the meaning specified in clause 2.2.8(1);

GAAP means generally accepted accounting practice in New Zealand, save that, where the cost of an asset is being determined in accordance with this determination, only the cost model of recognition is applied, insofar as an election may be made between the cost model of recognition and the fair value model of recognition;

GPB means GDB or GTB, as-

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

**grid output** has the same meaning as defined in the Capex IM;

**grid output incentive rate** has the same meaning as defined in the Capex IM;

**grid output target** has the same meaning as defined in the Capex IM;

**ID determination** means an information disclosure determination in relation to Transpower made by the Commission under s 52P of the Act;

**identifiable non-monetary asset** has the same meaning as under GAAP save that goodwill is excluded;

**incremental adjustment term** means the amount determined in accordance with clause 3.6.1(4);

**independent** means neither in a relationship with, nor having an interest in, Transpower that is likely to involve him, her or it in a conflict of interest between his, her or its duties to Transpower and his, her or its duties to the Commission;

**inflation rate** has the meaning specified in clause 3.6.1(5);

**initial RAB** has the meaning specified in clause 2.2.1;

**initial RAB value** means value of an asset in the **initial RAB** determined in accordance with clause 2.2.2;

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

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

**IPP** means individual price-quality path;

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

**land** excludes-

(a) buildings; and

(b) easements;

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

(a) Part 2, is the amount specified in clause 2.4.2(1); and

(b) Part 3, is the amount specified in clause 3.5.2(1);

**listed project** has the same meaning as defined in an IPP determination;
local authority has the same meaning as defined in s 5(1) of the Local Government Act 2002;

lost asset means an asset-
(a) not included in the initial RAB; and
(b) having, in relation to the disclosure year in question, an unallocated opening RAB value,

but determined by Transpower in that disclosure year never to have been used to provide electricity transmission services;

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

as the case may be, as each is estimated in accordance with clause 2.4.1; and
(b) Part 3, the mid-point estimate of vanilla WACC, as estimated in accordance with clause 3.5.1;

multi-rate PIE has the same meaning as defined in s YA 1 of the Income Tax Act 2007;

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

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

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

opening year means in respect of-

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

operating cost means a cost incurred by Transpower relating to the supply of electricity transmission services, and excludes-

(a) a cost that is treated as a cost of an asset by GAAP;
(b) amounts that are depreciation, tax, subvention payments, revaluations or an interest expense, in accordance with their meanings under GAAP; and
(c) pass-through costs; and
(d) recoverable costs;

operating expenditure means operating costs after application of clause 3.2.1;

P

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

physical asset life has the meaning specified in clause 2.2.6;

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

Q

qualifying debt has the meaning specified in clause 2.4.9(1);

qualifying issuer means a New Zealand resident limited liability company-

(a) that-

(i) undertakes the majority of its business activities in Australia and New Zealand; or
(ii) is part of a corporate group that undertakes the majority of its business activities in Australia and New Zealand;

(b) that-

(i) does not operate predominantly in the banking or finance industries; or
(ii) is part of a corporate group that does not operate predominantly in the banking or finance industries; and

(c) that issues vanilla NZ$ denominated bonds that are publicly traded;

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

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

RCP1 pseudo asset means the composite asset calculated in accordance with clause 2.2.9(2);

recoverable cost has the meaning specified in clause 3.1.3;

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

regulated supplier means a supplier of regulated goods or services;

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

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

related party means-

(a) a person that, in accordance with GAAP, is a related party to Transpower, other than as a result of Transpower being a Crown-owned entity; or
(b) any part of Transpower that does not supply electricity transmission services;

related party transaction means a transaction with a related party in accordance with GAAP;

remaining asset life means term remaining of an asset’s physical asset life, for the purposes of:

(a) clauses 2.2.4(1)(a) and 2.2.4(2)(a), at the commencement of the disclosure year in question; and
(b) clauses 2.2.4(1)(b) and 2.2.4(2)(b), at the asset’s commissioning date.

revenue-linked grid output measure has the same meaning as defined in the Capex IM;

s

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

standard error means estimated standard deviation;

standard physical asset life means life for an asset as specified in Schedule A;

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

system operator has the same meaning as defined in s 5 of the Electricity Industry Act 2010;
tax rules means the rules applicable to Transpower for determining income tax payable in the Income Tax Act 2007 (as amended from time to time, and any equivalent preceding legislation, or any subsequent legislation that supplements or replaces that Act);
term credit spread difference means the amount determined in accordance with clause 2.4.10;
term credit spread differential means the amount determined in accordance with, for the purpose of-
  (a) Part 2, clause 2.4.11; and
  (b) Part 3, clause 3.5.10;
term credit spread differential allowance means the sum of term credit spread differentials;
thresholds notice means the Commerce Act (Transpower Thresholds) Notice 2008;
Transpower has the same meaning as defined in s 54B of the Act;
unallocated closing RAB value means the value determined in accordance with clause 2.2.3(2);
unallocated depreciation means an allowance to account for the diminution in an asset's remaining service life potential in the disclosure year in question determined in accordance with clause 2.2.4(1);
unallocated initial RAB value means value of an asset in the initial RAB determined in accordance with clause 2.2.2(1);
unallocated opening RAB value means the value determined in accordance with clause 2.2.3(1);
value of commissioned asset means the value determined in accordance with clause 2.2.7;
value of found asset means the value determined in accordance with clause 2.2.8(2);
valuer means an individual who-
  (a) is registered as a valuer under the Valuers Act 1948;
  (b) holds a current practising certificate issued by-
    (i) the Property Institute of New Zealand; or
    (ii) the New Zealand Institute of Valuers;
  (c) has been engaged to act in his or her professional capacity as a valuer; and

Deleted: with respect to its unallocated opening RAB value and the amount of such allowance is
(d) is independent;

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

W

WACC means weighted average cost of capital;

works under construction means an asset, or a collection of assets that-
(a) has been or is being constructed by, or on behalf of, Transpower;
(b) has not been commissioned; and
(c) Transpower intends to commission.
PART 2  INPUT METHODOLOGIES FOR INFORMATION DISCLOSURE

SUBPART 1  Cost allocation

2.1.1  Cost allocation process
(1) For the purpose of any requirement in an ID determination to disclose-
   (a) asset values;
   (b) capital expenditure; or
   (c) operating costs,

   amounts or values thereof allocated to activities undertaken by Transpower to supply electricity transmission services other than system operator services must be net of amounts implicitly or explicitly recoverable by Transpower in respect of its supply of system operator services pursuant to any agreement in respect of such services between Transpower and the Electricity Authority.

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

SUBPART 2  Asset valuation

2.2.1  Composition of initial RAB

Initial RAB means assets included in the 2011 thresholds regulatory asset base, less-

   (a) excluded assets;
   (b) intangible assets, unless they are-
       (i) finance leases; or
       (ii) identifiable non-monetary assets; and
   (c) works under construction.

2.2.2  Initial RAB values for assets

(1) Subject to subclause (2), the unallocated initial RAB value of an asset is its value determined as of 30 June 2011 in accordance with the thresholds notice.

(2) For the purpose of subclause (1), where an asset is used by Transpower in the supply of system operator services, the unallocated initial RAB value is the value of the asset had no allocation of asset value relevant to the thresholds notice been undertaken.

(3) The initial RAB value of an asset is determined as the value allocated to electricity transmission services as a result of-
   (a) adopting its unallocated initial RAB value; and
   (b) applying clause 2.1.1 to it.
2.2.3 RAB roll forward

(1) Unallocated opening RAB value in respect of an asset in relation to-
   (a) the disclosure year 2012, is its unallocated initial RAB value; and
   (b) a disclosure year thereafter, is its unallocated closing RAB value in the preceding disclosure year.

(2) Unallocated closing RAB value means, in the case of-
   (a) a found asset, its value of found asset;
   (b) a disposed asset, nil;
   (c) a lost asset, nil;
   (d) any other asset with an unallocated opening RAB value, the value determined in accordance with the formula-
      \[
      \text{unallocated opening RAB value} - \text{unallocated depreciation};
      \]
   (e) an asset to which clause 2.2.7(4)(b)(i) applies, the result of the formula in paragraph (d), increased by the amount of expenditure described in clause 2.2.7(4)(b)(i) in the disclosure year in question; and
   (f) any other asset having a commissioning date in the disclosure year in question, the value determined in accordance with the formula-
      \[
      \text{value of commissioned asset} - \text{unallocated depreciation}.
      \]

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

(4) Closing RAB value, in respect of an asset, is determined as the value allocated to electricity transmission services by-
   (a) adopting its unallocated closing RAB value; and
   (b) applying 2.1.1 to it.

2.2.4 Depreciation

(1) Unallocated depreciation is determined, subject to subclause (3) and clause 2.2.5, in accordance with the formula, in the case of-
   (a) an asset with an unallocated opening RAB value –
      \[
      [1 ÷ \text{remaining asset life}] \times \text{unallocated opening RAB value}; \text{and}
      \]
   (b) an asset having a commissioning date in the disclosure year in question –
      \[
      [1 ÷ \text{remaining asset life}] \times \text{value of commissioned asset} \times \text{the fraction of the disclosure year from the commissioning date to the last day of the disclosure year}.
      \]

(2) Depreciation is determined, subject to subclause (3)(a), in accordance with the formula, in the case of-

   Deleted: in the case of an asset with an unallocated opening RAB value,
   Deleted: in the case of an asset with an opening RAB value,
(a) an asset with an opening RAB value—
\[
\left(1 \div \text{remaining asset life}\right) \times \text{opening RAB value}; \text{ and}
\]
(b) an asset having a commissioning date in the disclosure year in question—
\[
\left(1 \div \text{remaining asset life}\right) \times \text{value allocated to electricity transmission services by adopting the value of commissioned asset and applying clause 2.1.1 to it as if it were an asset value}
\]
\[
\times \text{the fraction of the disclosure year from the commissioning date to the last day of the disclosure year.}
\]

(3) For the purposes of subclauses (1) and (2)-
(a) unallocated depreciation and depreciation are nil in the case of-
(i) land;
(ii) an easement other than a fixed life easement; and
(iii) a network spare in respect of the period before which depreciation for the network spare in question commences under GAAP; and
(b) in all other cases, where an asset’s physical asset life at the end of the disclosure year is nil-
(i) unallocated depreciation is the asset’s unallocated opening RAB value; and
(ii) depreciation is the asset’s opening RAB value.

2.2.5 Unallocated depreciation constraint
(1) For the purpose of clause 2.2.4, and subject to subclause (2), the sum of unallocated depreciation of an asset calculated over its physical asset life may not exceed, in the case of an asset-
(a) in the initial RAB, its unallocated initial RAB value; or
(b) not in the initial RAB, its value of commissioned asset or value of found asset.

(2) For the purpose of subclause (1), the sum of increases to which clause 2.2.3(2)(e) refers for all disclosure years is treated as an increase in the value of commissioned asset of the asset in question.

2.2.6 Physical asset life
(1) Physical asset life means, subject to subclause (2), a finite period relating to an asset, being, in the case of-
(a) a fixed life easement, the fixed duration or fixed period (as the case may be) referred to in the definition of fixed life easement;
(b) a dedicated asset which is not expected to be used by Transpower to provide electricity transmission services beyond the term of the fixed term agreement relating to the asset between Transpower and the customer, at Transpower's election, the term of that agreement;
(c) an extended life asset or a refurbished asset, its physical service life potential as determined by Transpower;
(d) a stranded asset, the service life potential specified by the Commission;
(e) a reduced life asset, its physical service life potential determined by an engineer, subject to subclause (3);
(f) a found asset for which a similar asset exists as described in subclause 2.2.8(2)(b)(i), the asset life applying to the similar asset;
(g) the HVAC lines pseudo asset described in Schedule 1, clause 3(4)(d) of the thresholds notice, five years from 1 July 2011;
(h) an asset not referred to in paragraphs (a) to (g)-
   (i) having a standard physical asset life, its standard physical asset life;
   (ii) not having a standard physical asset life, if there is a similar physical asset in terms of asset type with an unallocated opening RAB value, the physical asset life of that similar physical asset; and
   (iii) in all other cases, the physical service life potential determined by an engineer, subject to subclause (3);
(i) a composite asset, the average asset life of the assets comprising it determined in accordance with paragraphs (a) to (h), with the modification that each such asset life must be weighted with respect to the proportion of its respective opening RAB value to the sum of the opening RAB values of the components in the earliest disclosure year in which all component assets were held by Transpower.

(2) For the purpose of subclause (1), the physical asset life at the start of a regulatory period of an asset that would, in accordance with subclause (1), become fully depreciated during that regulatory period, is equal to the duration of the regulatory period.

(3) For the purpose of subclauses (1)(e) and (1)(h)(iii), a determination of physical service life potential made by an engineer-
   (a) in relation to an asset with an unallocated opening RAB value is deemed applicable to all assets of similar asset type for which there is a requirement in this clause for an engineer's determination of physical service life potential; and
   (b) must be evidenced by a report written by that engineer that includes an acknowledgement that the report may be publicly disclosed by Transpower pursuant to an ID determination.

(4) In this clause-
(a) 'dedicated asset' means an asset operated for the benefit of a particular customer pursuant to a fixed term agreement for the supply of electricity transmission services between Transpower and that customer;
(b) 'extended life asset' means an asset whose physical service life potential is greater than its standard physical asset life;
(c) 'refurbished asset' means an asset on which work (other than maintenance) has been carried out resulting in an extension to its physical service life potential;
(d) 'reduced life asset' means an asset determined by Transpower to have a physical service life potential shorter than its standard physical asset life;
(e) 'stranded asset' means an asset-
   (i) that has an opening RAB value; and
   (ii) in respect of which, on application by Transpower and in accordance with any process for the purpose specified in an IPP determination, the Commission has determined a service life potential shorter than its standard physical asset life; and
(f) 'composite asset' means a configuration of two or more assets that is not capable of operation in the absence of any of those assets.

2.2.7 Value of commissioned assets

(1) Value of commissioned asset, in relation to an asset, is the cost of the asset to Transpower determined by applying GAAP to the asset as on its commissioning date, except that the cost of-

(a) an intangible asset, unless it is-
   (i) a finance lease; or
   (ii) an identifiable non-monetary asset,
   is nil;
(b) an easement created by Transpower in respect of easement land, is limited to the sum of-
   (i) legal and administrative costs incurred by Transpower in relation to the easement's creation;
   (ii) compensation, determined by a valuer, for any amount that would otherwise have been paid by Transpower on arm’s-length terms to a third party owner of easement land as compensation for the permanent and material reduction in the value of the land or disruption, on account of the easement's creation; and
   (iii) the cost of financing the purchase of the easement land, determined in respect of the period on and from the date of acquisition until the easement's creation,
where any gain or loss made by Transpower on the sale or disposal of the easement land is ignored;

(c) easement land, is nil;

(d) an asset used in providing electricity transmission services pursuant to a new investment contract, is nil;

(e) a network spare whose cost is not treated wholly as or part of the cost of an asset under GAAP, is nil;

(f) an asset-

(i) acquired from another regulated supplier; and

(ii) used by that regulated supplier in the supply of regulated goods or services,

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

(g) an asset that was previously used by Transpower in its supply of other regulated goods or services is limited to the unallocated opening RAB value of the asset in relation to those other regulated goods or services as on the day before the commissioning date (as ‘unallocated opening RAB value’ is defined in the input methodologies applying to the regulated goods or services supplied by Transpower); and

(h) an asset acquired from a related party in a related party transaction other than an asset to which paragraphs (f) or (g) apply is-

(i) its depreciated historic cost in respect of the related party determined by applying GAAP as on the day before the acquisition by the Transpower; or

(ii) where sufficient records do not exist to establish this cost, its market value as at its commissioning date as determined by a valuer.

(2) When applying GAAP for the purpose of subclause (1), the cost of financing-

(a) is applicable only in respect of the period commencing on the date the asset becomes a works under construction and terminating on its commissioning date; and

(b) is calculated using, subject to subclause (3), a rate no greater than the 75th percentile estimate of WACC applying in respect of the relevant date for its calculation under GAAP.

(3) For the purposes of subclause (2)(b)-

(a) where no WACC in respect of the relevant date has been published pursuant to clause 3.5.8, the rate is calculated using a rate no greater than Transpower’s estimate of its post-tax WACC as at the relevant date for its calculation under GAAP; and
(b) where an asset has not been commissioned within the period to which the 75th percentile estimate of WACC referred to in subclause (2)(b) applied, the cost of financing after that period is calculated using a rate no greater than the 75th percentile estimate of WACC applying to that later period.

(4) For the avoidance of doubt-

(a) revenue derived in relation to works under construction that is not included in regulatory income under an ID determination or preceding regulatory information disclosure requirements reduces the cost of an asset by the amount of the revenue where such reduction is not otherwise made under GAAP;

(b) where expenditure on an asset which forms part of the cost of that asset under GAAP is incurred by Transpower after the asset was first commissioned, such expenditure may be treated, at Transpower's election, as relating to-

(i) that asset; or

(ii) a separate asset.

2.2.8 Value of found assets

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

(a) other than easement land;

(b) other than an intangible asset, unless it is-

(i) a finance lease; or

(ii) an identifiable non-monetary asset; and

(c) not having a commissioning date in the disclosure year in question;

(d) the value of which-

(i) is not included as an unallocated opening RAB value in the disclosure year in question nor was so included in any prior disclosure year in accordance with clause 2.2.3(1); and

(ii) was not included in an unallocated closing RAB value in any prior disclosure year in accordance with clause 2.2.3(2); and

(e) first determined by Transpower in the disclosure year in question to have a commissioning date after the disclosure year 2011.

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

(a) its cost calculated consistently with GAAP; or

(b) where sufficient records do not exist to establish its cost for the purposes of GAAP,

(i) where an asset with an unallocated opening RAB value for that disclosure year is similar (in terms of asset type and age) to the found asset, the unallocated opening RAB value of the similar asset; and
(ii) in all other cases, its market value as determined by a **valuer** as at the
date that the asset was first determined by **Transpower** to have been
**commissioned** in a prior disclosure year after the **disclosure year 2011**.

2.2.9 Adjustment to asset values and establishment of RCP1 pseudo asset

(1) Each asset with a **commissioning date** in the period commencing
(a) on the first day of the **disclosure year 2012**; and
(b) ending on the last day of the **disclosure year 2015**,
shall have its values calculated pursuant to-
(c) clause 2.2.3(1); and
(d) clause 2.2.3(3),
for the **disclosure year 2016** adjusted by the amounts necessary to produce the value
for each asset as if **depreciation** had applied for the **disclosure year** in which the asset’s
**commissioning date** occurred.

(2) The ‘RCP1 pseudo asset’ is a composite asset established as of the first day of the
**disclosure year 2016** with-
(a) an **unallocated opening RAB value** equal to the sum of adjustments for all
assets made under subclause (1) in respect of clause 2.2.3(1);
(b) an **opening RAB value** equal to the sum of all adjustments for all assets
made under subclause (1) in respect of clause 2.2.3(3); and
(c) a physical asset life determined pursuant to clause 2.2.6(1)(i) where, for the
 **purpose** of that clause-
(i) the amount of each adjustment made in respect of clause 2.2.3(3) shall
be considered the ‘**opening RAB value**’ for a component asset with an
asset life corresponding to that of the asset adjusted, and
(ii) the ‘**disclosure year**’ is the **disclosure year 2016**.

SUBPART 3 Treatment of taxation

2.3.1 **Regulatory tax allowance**

(1) **Regulatory tax allowance** is determined by applying the **tax rules** and the **corporate tax rate** to the regulatory profit / (loss) before tax.

(2) For the purpose of subclause (1), 'regulatory profit / (loss) before tax’ means the amount of 'regulatory profit / (loss) before tax', as determined in accordance with an **ID determination**.

(3) For the purpose of subclause (1), in applying the **tax rules** in respect of particular items of income and expenses included in 'regulatory profit / (loss) before tax’-
(a) a tax deduction for interest incurred in relation to debt must be substituted
with a tax deduction for notional deductible interest;
(b) any tax deduction for depreciation in respect of an asset must be calculated by applying the tax rules to the regulatory tax asset value; and
(c) the effect of any-
   (i) tax losses (other than those produced from the supply of electricity transmission services); and
   (ii) subvention payment,
   made by Transpower must be ignored.

(4) For the purpose of subclause (3)(a), 'notional deductible interest' means the amount determined in accordance with the formula-

\[
\text{notional deductible interest} = \left( \text{sum of opening RAB values} \times \text{leverage} \times \text{cost of debt} \right) + \text{term credit spread differential allowance}.
\]

2.3.2 Regulatory tax asset value

(1) Regulatory tax asset value, in relation to an asset, means the value determined in accordance with the formula-

\[
\text{tax asset value} \times \text{result of asset allocation ratio}.
\]

(2) For the purpose of subclause (1), 'tax asset value' means, in respect of-
   (a) an asset-
      (i) acquired from a regulated supplier who used it to supply regulated goods or services; or
      (ii) acquired or transferred from a related party,
      the value of the asset determined by applying the tax depreciation rules to its notional tax asset value; and
   (b) any other asset, its adjusted tax value.

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

(4) 'Notional tax asset value' means, for the purpose of-
   (a) subclause (2)(a)(i), value after applying the tax depreciation rules to the tax asset value (as 'tax asset value' is defined in the input methodologies applying to the regulated goods or services in question) in respect of the disclosure year in which the asset was acquired; and
   (b) subclause (2)(a)(ii), value in respect of the disclosure year in which the asset was acquired or transferred that is-
      (i) consistent with the tax rules; and
      (ii) limited to its value of commissioned asset.
(5) For the purpose of subclause (1), 'result of asset allocation ratio' means, where an asset or group of assets maintained under the tax rules-

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

\[
\text{opening RAB value or sum of opening RAB values, as the case may be} \div \text{unallocated opening RAB value or sum of unallocated opening RAB values, as the case may be},
\]

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

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

SUBPART 4 Cost of capital

2.4.1 Methodology for estimating weighted average cost of capital

(1) The Commission will determine a mid-point estimate of vanilla WACC for the disclosure year 2011 and each disclosure year thereafter-

(a) in respect of the 5 years commencing on the first day of the disclosure year in question;

(b) subject to subclause (3), within 1 month of the start of the disclosure year in question; and

(c) in accordance with the formula-

\[ r_d (1 - T_c) L + r_e (1 - L). \]

(2) The Commission will determine a mid-point estimate of post-tax WACC for the disclosure year 2011 and each disclosure year thereafter-

(a) in respect of the 5 years commencing on the first day of the disclosure year in question;

(b) subject to subclause (3), within 1 month of the start of the disclosure year in question; and

(c) in accordance with the formula-

\[ r_d (1 - T_c) L + r_e (1 - L). \]

(3) The Commission will estimate or determine, as the case may be, the amounts or values-

(a) to which this subclause applies; and

(b) in respect of the disclosure year 2011,
as soon as practicable after this determination comes into force.

(4) In this clause-

L is leverage;

rd is the cost of debt and is estimated by \( r_f + p + d \);

re is the cost of equity and is estimated by \( r_f(1 - T_i) + \beta \cdot TAMRP \);

Tc is the average corporate tax rate;

rf is the risk free rate;

p is the debt premium;

d is the debt issuance costs;

Ti is the average investor tax rate;

\( \beta \) is the equity beta; and

TAMRP is the tax-adjusted market risk premium.

(5) For the purpose of this clause-

(a) the average investor tax rate, the equity beta, the debt issuance costs, the average corporate tax rate and the tax-adjusted market risk premium are the values specified in or determined in accordance with clause 2.4.2; and

(b) the risk-free rate must be estimated in accordance with clause 2.4.3.

2.4.2 Fixed WACC parameters

(1) Leverage is 44%.

(2) The average investor tax rate is the average of the investor tax rates that, as at the date that the estimation is made, will apply to each of the disclosure years in the 5 year period commencing on the first day of the disclosure year in question.

(3) For the purpose of subclause (2), 'investor tax rate' is-

(a) for the disclosure year 2011, 28.5%; and

(b) for each disclosure year thereafter, the maximum prescribed investor rate applicable at the start of that disclosure year to an individual who is-

(i) resident in New Zealand; and

(ii) an investor in a multi-rate PIE.

(4) The average corporate tax rate is the average of the corporate tax rates that, as at the date that the estimation is made, will apply during the 5 year period commencing on the first day of the disclosure year in question.

(5) The equity beta is 0.61.

(6) The debt issuance costs are 0.35%.

(7) The tax-adjusted market risk premium is, for a 5 year period commencing on the first day of-

(a) the disclosure year 2011, 7.1%; and
(b) a disclosure year thereafter, 7.0%.

2.4.3 Methodology for estimating risk-free rate

The Commission will estimate a risk-free rate-

(a) for each disclosure year; and

(b) subject to clause 2.4.1(3), within 1 month of the start of the disclosure year in question,

by-

(c) obtaining, for notional benchmark New Zealand government New Zealand dollar denominated nominal bonds the wholesale market linearly-interpolated bid yield to maturity, for a residual period to maturity equal to 5 years on each business day in the month preceding the start of the disclosure year;

(d) calculating the annualised interpolated bid yield to maturity for each business day; and

(e) calculating the un-weighted arithmetic average of the daily annualised interpolated bid yields to maturity.

2.4.4 Methodology for estimating debt premium

(1) Debt premium means the spread between-

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

(i) are issued by an EDB or a GPB;

(ii) are publicly traded;

(iii) have a qualifying rating of grade BBB+; and

(iv) have a remaining term to maturity of 5 years; and

(b) the contemporaneous interpolated bid yield to maturity of benchmark New Zealand government New Zealand dollar denominated nominal bonds having a remaining term to maturity of 5 years.

(2) The Commission will estimate an amount for the debt premium-

(a) for each disclosure year; and

(b) subject to clause 2.4.1(3), within 1 month of the start of each disclosure year.

(3) The amount of the debt premium will be estimated by-

(a) identifying publicly traded vanilla NZ$ denominated bonds issued by a qualifying issuer that are-

(i) investment grade credit rated; and

(ii) of a type described in the paragraphs of subclause (4);

(b) in respect of each bond identified in accordance with paragraph (a)-

(i) obtaining its wholesale market annualised bid yield to maturity;
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(ii) calculating by linear interpolation with respect to maturity, the contemporaneous wholesale market annualised bid yield to maturity for a notional benchmark New Zealand government New Zealand dollar denominated nominal bond with the same remaining term to maturity; and

(iii) calculating its contemporaneous interpolated bid to bid spread over notional benchmark New Zealand government New Zealand dollar denominated nominal bonds with the same remaining term to maturity, by deducting the yield calculated in accordance with sub-paragraph (ii) from the yield obtained in accordance with sub-paragraph (i), for each business day in the month immediately preceding the start of the disclosure year;

(c) calculating, for each bond identified in accordance with paragraph (a), the un-weighted arithmetic average of the daily spreads identified in accordance with paragraph (b)(iii); and

(d) subject to subclause (4), estimating, by taking account of the average spreads identified in accordance with paragraph (c), the average spread that would reasonably be expected to apply to a vanilla NZ$ denominated bond that-

(i) is issued by an EDB or a GPB that is neither majority owned by the Crown nor a local authority;

(ii) is publicly traded;

(iii) has a qualifying rating of grade BBB+; and

(iv) has a remaining term to maturity of 5 years.

(4) For the purpose of subclause (3)(d), the Commission will have regard, subject to subclause (5), to the spreads observed on the following types of vanilla NZ$ denominated bonds issued by a qualifying issuer:

(a) those that-

(i) have a qualifying rating of grade BBB+; and

(ii) are issued by an EDB or a GPB that is neither majority owned by the Crown nor a local authority;

(b) those that-

(i) have a qualifying rating of grade BBB+; and

(ii) are issued by an entity other than an EDB or a GPB that is neither majority owned by the Crown nor a local authority;

(c) those that-

(i) have a qualifying rating of a grade different to BBB+; and

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

(e) those that are-
   (i) investment grade credit rated; and
   (ii) issued by an entity that is majority owned by the Crown or a local
        authority.

(5) For the purpose of subclause (4)-
   (a) progressively lesser regard will ordinarily be given to the spreads observed
       on the bond types described in subclause (4) in accordance with the order in
       which the bond types are described;
   (b) the spread on any bond of the type described in subclause (4) that has a
       remaining term to maturity of less than 5 years will ordinarily be considered
       to be the minimum spread that would reasonably be expected to apply on
       an equivalently credit-rated bond issued by the same entity with a remaining
       term to maturity of 5 years; and
   (c) the Commission will adjust spreads observed on bonds described under
       subclauses (4)(b) to (4)(e) to approximate the spread that is likely to have
       been observed had the bonds in question been of the type described in
       subclause (4)(a).

2.4.5 Standard error of debt premium

(1) The Commission will estimate an amount for a standard error of the debt premium-
   (a) subject to clause 2.4.1(3), within 1 month of the start of the disclosure year
       in question; and
   (b) as either-
        (i) the result of the formula specified in subclause (2); or
        (ii) 0.0015,
        whichever is the greater.

(2) For the purpose of subclause (1)(b)(i), the formula is-

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

where-
\( N \) is the number of qualifying issuers issuing bonds of the type described in the subparagraphs of clause 2.4.4(3)(d);

\( p_i \) is each qualifying issuer's arithmetic average spread for its bonds of the type described in the subparagraphs of clause 2.4.4(3)(d); and

\( \hat{p} \) is the debt premium,

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

2.4.6 Methodology for estimating the WACC standard error

(1) The Commission will determine a standard error of a mid-point estimate of WACC-

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

(b) in accordance with this clause.

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

\[
\sqrt{0.00003 + 0.0169 E^2(TAMRP) + 0.1936 \text{var}(\hat{p})}.
\]

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

\[
\sqrt{0.00003 + 0.0169 E^2(TAMRP) + (1 - T_c)^2 (0.1936 \text{var}(\hat{p}))}.
\]

(4) In this clause-

(a) \( E^2(TAMRP) \) is the square of the tax-adjusted market risk premium determined in accordance with clause 2.4.2(7);

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

(c) \( T_c \) is the average corporate tax rate determined in accordance with clause 2.4.2(4).

2.4.7 Methodology for estimating the WACC range

(1) The Commission will determine a WACC range for each mid-point estimate of WACC-

(a) for each disclosure year; and

(b) subject to clause 2.4.1(3), within 1 month of the start of the disclosure year in question.

(2) For the purpose of subclause (1), 'WACC range' means the values falling between the 25th percentile and 75th percentile inclusive of the mid-point estimate of WACC.

(3) For the purpose of subclause (2)-
(a) the mid-point estimate of WACC must be treated as the 50th percentile; and
(b) the

(i) 75th percentile must be determined in accordance with the formula:

\[
\text{mid-point estimate of WACC} + 0.674 \times \text{standard error};
\]

and

(ii) 25th percentile must be determined in accordance with the formula:

\[
\text{mid-point estimate of WACC} - 0.674 \times \text{standard error},
\]

where ‘standard error’ means the standard error of the relevant mid-point estimate of WACC, as determined in accordance with clause 2.4.6(2) or 2.4.6(3), as the case may be.

2.4.8 Publication of estimates relating to cost of capital

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

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

2.4.9 Interpretation of terms relating to term credit spread differential

(1) Qualifying debt means a line of debt-

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

(2) Cost of executing an interest rate swap means the amount determined in accordance with the formula-

\[
A \times B,
\]

where-

(a) ‘A’ is the amount that is half of the New Zealand dollar wholesale bid and offer spread for a vanilla interest rate swap determined at the time of pricing the qualifying debt (which, for the avoidance of doubt, is expressed in terms of basis points per annum); and
(b) ‘B’ is the book value in New Zealand dollars of the qualifying debt at its date of issue.

2.4.10 Term credit spread difference

(1) Term credit spread difference is determined in accordance with the formula-

\[
T \times U,
\]

where-

(a) ‘T’ is the amount determined in accordance with the formula-

\[
(V - W) - (X - Y);
\]
except that where that amount is-

(i) less than 0.0015, T is 0.0015; and
(ii) more than 0.006, T is 0.006; and

(b) ‘U’ is the book value in New Zealand dollars of the qualifying debt at its date of issue.

(2) For the purpose of subclause (1)-

(a) ‘V’ is the yield shown on the Bloomberg New Zealand 'A' fair value curve for a bond with a tenor equal to, or closest to, the original tenor of the qualifying debt;
(b) ‘W’ is the New Zealand swap rate quoted by Bloomberg for a tenor equal to the original tenor of the qualifying debt;
(c) ‘X’ is the yield shown on the Bloomberg New Zealand 'A' fair value curve for a bond with a tenor of 5 years;
(d) ‘Y’ is the New Zealand swap rate quoted by Bloomberg for a tenor of 5 years; and
(e) V, W, X and Y are determined as at the same time on the same pricing date of the qualifying debt.

(3) For the purpose of this clause, where the qualifying debt is issued to a related party, ‘original tenor of the qualifying debt’ means the-

(a) tenor of the qualifying debt; or
(b) period from the qualifying debt’s date of issue to the earliest date on which its repayment is or may be required,

whichever is the shorter.

2.4.11 Methodology for estimating term credit spread differential

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

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

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

(3) Term credit spread differential is the amount determined in accordance with the formula-

\[(A \div B) \times C \times D,\]

where-

(a) ‘A’ is the sum of the-

(i) term credit spread difference;
(ii) cost of executing an interest rate swap; and
(iii) the debt issuance cost re-adjustment;

(b) 'B' is the book value of Transpower's total interest-bearing debt as at the date to which its financial statements audited and published in the disclosure year in question relate;

c) 'C' is leverage; and

d) 'D' is the average of-

(i) the sum of opening RAB values; and
(ii) the sum of closing RAB values.

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

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

which amount, for the avoidance of doubt, will be a negative number.
PART 3 INPUT METHODOLOGIES APPLYING TO INDIVIDUAL PRICE-
QUALITY PATH

SUBPART 1 Specification of price

3.1.1 Price
For the purpose of s 53M(1)(a) of the Act, the maximum revenues that may be recovered by Transpower will be specified in a s 52P determination as a total revenue cap, net of-
(a) the sum of pass-through costs; and
(b) the sum of recoverable costs.

3.1.2 Pass-through cost requirements
(1) A pass-through cost is a cost that-
   (a) is listed in subclause (2); or
   (b) is a levy, other than one listed in subclause (2), that meets the criteria specified in subclause (3).
(2) For the purpose of subclause (1)(a), the costs are-
   (a) rates on system fixed assets paid or payable by Transpower to a local authority under the Local Government (Rating) Act 2002; and
   (b) levies payable under regulations made under-
      (i) s 53ZE of the Act; or
      (ii) the Electricity Industry Act 2010.
(3) For the purpose of subclause (1)(b), the criteria are that the levy-
   (a) is-
      (i) associated with the provision of electricity transmission services;
      (ii) outside the control of Transpower;
      (iii) not a recoverable cost;
      (iv) appropriate to be passed through to Transpower’s customers; and
      (v) one in respect of which provision for its partial or full recovery is not made explicitly or implicitly in the IPP;
   (b) was reasonably unforeseen at the time the IPP determination was made;
   (c) comes into effect during any disclosure year commencing in a regulatory period; and
   (d) is specified as a ‘pass-through cost’ by way of amendment to the IPP determination.
(4) In this clause, ‘levy’ means a tax, charge or fee directly imposed by or under legislation-
   (a) on-
      (i) Transpower alone; or
(ii) a class of persons (other than the general public or businesses in general) that includes Transpower; or

(b) in relation to electricity transmission services.

3.1.3 Recoverable costs

(1) A recoverable cost is a cost that is-

(a) any positive net balance determined in accordance with clause 3.6.2(2), provided that any requirements pursuant to an ID determination regarding auditor certification of the value determined in accordance with those clauses have been met;

(b) subject to subclause (2), an instantaneous reserves availability charge, being a charge allocated to Transpower under-

(i) rule 8.59 of the Electricity Industry Participation Code; or

(ii) any Act or regulations that replace that rule, net of any rebate received by Transpower in accordance with rule 8.65 of the Electricity Industry Participation Code;

(c) a transmission alternative operating cost, subject to the requirements in subclause (3), not to exceed the-

(i) actual transmission alternative operating cost incurred by Transpower; or

(ii) upper limit of transmission alternative operating costs approved in accordance with subclause (3), whichever is lower;

(d) any operating costs incurred as part of a major capex project, subject to the requirements in subclause (3); and

(e) following a reconsideration and amendment of the IPP under clauses 3.7.4(2)(a) and 3.7.5(1), the prudent net additional operating costs, incurred in excess of those provided in an IPP determination in responding to a catastrophic event until the effective date of the amended IPP, as determined by the Commission in the amended IPP determination.

(2) For the purpose of subclause (1)(b), an instantaneous reserves availability charge excludes-

(a) any 'event charges' payable by Transpower, as defined under-

(i) rule 8.64 of the Electricity Industry Participation Code, or

(ii) any Act or regulations that replace that rule;

(b) 50% of any such charge incurred by Transpower, except one incurred as a direct result of decommissioning of Pole 1 of the HVDC link, in relation to an asset remaining out of service after an initial period of 14 consecutive days out of service, insofar as the cumulative amount so incurred is less than or
equal to 1% of Transpower's forecast MAR for the disclosure year in which the event causing the asset to be out of service commences, as specified in the IPP determination;

(c) any such charge treated as capital expenditure (in accordance with GAAP) by Transpower in relation to the control systems integration of Pole 2 and the commissioning of Pole 3 of the HVDC link; and

(d) any such charge that is treated as having been inefficiently incurred under GAAP.

(3) For the purpose of subclauses (1)(c) and (d), the requirements are that the cost must -

(a) be operating expenditure;

(b) be incremental to the operating expenditure allowance specified by the Commission in the IPP determination; and

(c) have been approved by the-

(i) Electricity Commission under Part F of the Electricity Governance Rules 2003;

(ii) Commission in accordance with s 54R(3)(b) of the Act; or

(iii) Commission in accordance with any input methodology determined pursuant to s 54S of the Act.

(4) In this clause-

(a) 'Act' and 'Regulations' have the same meanings as defined in s 29 of the Interpretation Act 1999; and

(b) 'Electricity Industry Participation Code' has the same meaning as 'code' is defined in the Electricity Industry Act 2010.

SUBPART 2 Cost allocation

3.2.1 Cost allocation

(1) For the purpose of making an IPP determination, information provided to the Commission by Transpower regarding Transpower's operating costs and capital expenditure, whether actual or forecast, must be provided in accordance with clause 2.1.1 with necessary modifications.

(2) For the avoidance of doubt, in applying subclause (1), any reference to 'any requirement in an ID determination' in Subpart 1 of Part 2 means 'any requirement specified by the Commission'.

SUBPART 3 Asset valuation

3.3.1 Asset valuation

For the purpose of making an IPP determination-

(a) the value of an asset; and

(b) any allowance for depreciation,
must be determined in accordance with the input methodologies specified in Subpart 2 of Part 2, with necessary modifications to allow-

(c) such values or allowances to be calculated on a forecast basis where required; and

(d) for the purposes of determining forecast MAR and associated annual wash-ups, the determination of the value of commissioned asset by reference to approved amounts of capital expenditure.

SUBPART 4  Treatment of taxation

3.4.1 Treatment of taxation

(1) For the purpose of making an IPP determination, Transpower’s regulatory tax allowance whether on an actual or forecast basis, must be determined in accordance with the input methodologies specified in Subpart 3 of Part 2 with necessary modifications.

(2) For the avoidance of doubt, in applying subclause (1), 'as determined in accordance with an ID determination' in clause 2.3.1(2) shall be construed as 'as specified by the Commission'.

SUBPART 5  Cost of capital

3.5.1 Methodology for estimating weighted average cost of capital

(1) The Commission will determine mid-point estimates of vanilla WACC-

(a) as of the first business day of the month 7 months prior to the start of each regulatory period;

(b) in respect of a 5 year period;

(c) subject to subclause (2), no later than 6 months preceding the start of RCP1 or each other regulatory period as the case may be; and

(d) in accordance with the formula-

\[ r_d L + r_e (1 - L). \]

(2) The Commission will estimate or determine, as the case may be, the amounts or values-

(a) to which this subclause applies; and

(b) in respect of RCP1,

as soon as practicable after this determination comes into force.

(3) In this clause-

\( L \) is leverage;

\( r_d \) is the cost of debt and is estimated by \( r_f + p + d \);

\( r_e \) is the cost of equity and is estimated by \( r_f (1 - T_f) + \beta_e TAMRP \);

\( r_f \) is the risk-free rate.
$p$ is the debt premium;
$d$ is the debt issuance costs;
$T_i$ is the average investor tax rate;
$\beta_e$ is the equity beta; and
$TAMRP$ is the tax-adjusted market risk premium.

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

3.5.2 Fixed WACC parameters

(1) Leverage is 44%.
(2) The average investor tax rate is the average of the investor tax rates that, as at the date that the estimation is made, will apply to each of the disclosure years in the 5 year period commencing on the first day of the regulatory period in question.
(3) For the purpose of subclause (2), 'investor tax rate' is-
(a) for the disclosure year 2011, 29%; and
(b) for a disclosure year thereafter, the maximum prescribed investor rate that, as at the date that the estimation is made, will apply at the start of that disclosure year to an individual who is-
   (i) resident in New Zealand; and
   (ii) an investor in a multi-rate PIE.
(4) The equity beta is 0.61.
(5) The debt issuance costs are 0.35%.
(6) The tax-adjusted market risk premium is, for a 5 year period commencing on the first day of-
   (a) until 30 June 2011, 7.1%; and
   (b) on and after 1 July 2011, 7%.

3.5.3 Methodology for estimating risk-free rate
The Commission will estimate a risk-free rate-
(a) as of the first business day of the month 7 months prior to the start of each regulatory period;
(b) in respect of a 5 year period; and
subject to clause 3.5.1(2), no later than 6 months prior to the start of each regulatory period,

by-

(d) obtaining, for notional benchmark New Zealand government New Zealand dollar denominated nominal bonds the wholesale market linearly-interpolated bid yield to maturity, for a residual period to maturity equal to 5 years on each business day in the month 8 months prior to the start of each regulatory period;

(e) calculating the annualised interpolated bid yield to maturity for each business day; and

(f) calculating the un-weighted arithmetic average of the daily annualised interpolated bid yields to maturity.

3.5.4 Methodology for estimating debt premium

(1) 
Debt premium means the spread between-

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

(i) are issued by an EDB or a GPB;
(ii) are publicly traded;
(iii) have a qualifying rating of grade BBB+; and
(iv) have a remaining term to maturity of 5 years; and

(b) the contemporaneous interpolated bid yield to maturity of benchmark New Zealand government New Zealand dollar denominated nominal bonds having a remaining term to maturity of 5 years.

(2) The Commission will estimate an amount for the debt premium-

(a) for each regulatory period; and

(b) subject to clause 3.5.1(2), no later than 6 months prior to the start of each regulatory period.

(3) The amount of the debt premium will be estimated as of the first business day of the month 7 months prior to the start of each regulatory period by-

(a) identifying publicly traded vanilla NZ$ denominated bonds that are-

(i) investment grade credit rated; and
(ii) of a type described in the paragraphs of subclause (4);

(b) in respect of each bond identified in accordance with paragraph (a)-

(i) obtaining its wholesale market annualised bid yield to maturity;
(ii) calculating by linear interpolation with respect to maturity, the contemporaneous wholesale market annualised bid yield to maturity for a notional benchmark New Zealand government New Zealand dollar denominated nominal bond with the same remaining term to maturity; and
(iii) calculating its contemporaneous interpolated bid to bid spread over notional benchmark New Zealand government New Zealand dollar denominated nominal bonds with the same remaining term to maturity, by deducting the yield calculated in accordance with sub-paragraph (ii) from the yield obtained in accordance with sub-paragraph (i), for each business day in the month 8 months prior to the start of the regulatory period;

(c) calculating, for each bond identified in accordance with paragraph (a), the un-weighted arithmetic average of the daily spreads identified in accordance with paragraph (b)(iii); and

(d) subject to subclause (4), estimating, by taking account of the average spreads identified in accordance with paragraph (c), the average spread that would reasonably be expected to apply to a vanilla NZ$ denominated bond that-

(i) is issued by an EDB or a GPB that is neither majority owned by the Crown nor a local authority;

(ii) is publicly traded;

(iii) has a qualifying rating of grade BBB+; and

(iv) has a remaining term to maturity of 5 years.

(4) For the purpose of subclause (3)(d), the Commission will have regard, subject to subclause (5), to the spreads observed on the following types of vanilla NZ$ denominated bonds issued by a qualifying issuer:

(a) those that-

(i) have a qualifying rating of grade BBB+; and

(ii) are issued by an EDB or a GPB that is neither majority owned by the Crown nor a local authority;

(b) those that-

(i) have a qualifying rating of grade BBB+; and

(ii) are issued by an entity other than an EDB or a GPB that is neither majority owned by the Crown nor a local authority;

(c) those that-

(i) have a qualifying rating of a grade different to BBB+; and

(ii) are issued by an EDB or a GPB that is neither majority owned by the Crown nor a local authority;

(d) those that-

(i) have a qualifying rating of a grade different to BBB+; and

(ii) are issued by an entity, other than an EDB or a GPB that is neither majority owned by the Crown nor a local authority; and
(e) those that are-

(i) investment grade credit rated; and

(ii) issued by an entity that is majority owned by the Crown or a local authority.

(5) For the purpose of subclause (4)-

(a) progressively lesser regard will ordinarily be given to the spreads observed on the bond types described in subclause (4) in accordance with the order in which the bond types are described;

(b) the spread on any bond of the type described in subclause (4) that has a remaining term to maturity of less than 5 years will ordinarily be considered to be the minimum spread that would reasonably be expected to apply on an equivalently credit-rated bond issued by the same entity with a remaining term to maturity of 5 years; and

(c) the Commission will adjust spreads observed on bonds described under subclauses (4)(b) to (4)(e) to approximate the spread that is likely to have been observed had the bonds in question been of the type described in subclause (4)(a).

3.5.5 Standard error of debt premium

(1) The Commission will estimate an amount for a standard error of a debt premium-

(a) subject to clause 3.5.1(2), no later than 6 months prior to the start of each regulatory period; and

(b) as either-

(i) the product of the formula specified in subclause(2); or

(ii) 0.0015,

whichever is the greater.

(2) For the purpose of subclause (1)(b)(i), the formula is-

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

where-

- $N$ is the number of qualifying issuers issuing bonds of the type described in the subparagraphs of clause 3.5.4(3)(d);

- $p_i$ is each qualifying issuer's arithmetic average spread for its bonds of the type described in the subparagraphs of clause 3.5.4(3)(d); and

- $\bar{p}$ is the debt premium,

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

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

(a) subject to clause 3.5.1(2), no later than 6 months prior to the start of each regulatory period; and

(b) in accordance with the formula-

\[ \sqrt{0.00003 + 0.0169E^2(TAMRP) + 0.1936 \text{var}(\hat{p})}, \]

where-

\( E^2(TAMRP) \) is the square of the tax-adjusted market risk premium determined in accordance with clause 3.5.2(6); and

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

3.5.7 Methodology for estimating 75th percentile of vanilla WACC

(1) The Commission will determine a 75th percentile estimate of WACC-

(a) for each regulatory period;

(b) no later than 6 months prior to the start of each regulatory period.

(2) For the purpose of subclause (1)-

(a) the mid-point estimate of WACC must be treated as the 50th percentile; and

(b) the 75th percentile must be determined in accordance with the formula-

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

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

3.5.8 Publication of estimates

The Commission will publish all determinations and estimates that it is required to make by this subpart-

(a) on its website; and

(b) no later than 1 month after having made them.

3.5.9 Use of published estimates of WACC

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

(1) This clause applies to the determination of the amount of any term credit spread differential in respect of a qualifying debt for the purpose of determining a term credit spread differential allowance in an IPP determination.

(2) The Commission will only determine a term credit spread differential allowance if Transpower’s debt portfolio, as at the date of its most recently published audited financial statements, has a weighted average original tenor greater than 5 years.

(3) Term credit spread differential is the amount determined in accordance with the formula -

\[
(A \div B) \times C \times D,
\]

where -

(a) 'A' is the sum of the-

(i) term credit spread difference;

(ii) cost of executing an interest rate swap; and

(iii) debt issuance cost re-adjustment;

(b) 'B' is the book value of the qualifying supplier's total interest-bearing debt as at the date to which Transpower's financial statements audited and published most recently before the IPP determination is made;

(c) 'C' is leverage; and

(d) 'D' is, in relation to the qualifying supplier, the average of-

(i) the sum of opening RAB values; and

(ii) the sum of closing RAB values.

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

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

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

SUBPART 6 Incremental rolling incentive scheme

3.6.1 Calculation of annual incremental changes and adjustment term

(1) The incremental change for an opening year is the difference between allowed controllable opex and actual controllable opex.

(2) The incremental change for a disclosure year of the regulatory period other than the opening year or final disclosure year must be determined in accordance with the formula -

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

where -
\( t \) means the disclosure year in question; and
\( t-1 \) means the disclosure year preceding the disclosure year in question.

(3) The incremental change for the final disclosure year of the regulatory period is treated as nil.

(4) The incremental adjustment term is determined-

(a) in the opening year of every regulatory period except RCP1; and

(b) by applying the inflation rate to the result of the formula-

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

where-

\( t-1 \) means the final disclosure year commencing in the preceding regulatory period; and

\( t-2 \) means the penultimate disclosure year commencing in the preceding regulatory period.

(5) Inflation rate means the amount determined in accordance with the formula-

\[
[(CPI_1 + CPI_2 + CPI_3 + CPI_4) ÷ (CPI_1 - 4 + CPI_2 - 4 + CPI_3 - 4 + CPI_4 - 4)] - 1,
\]

where-

\( CPI_n \) means forecast CPI for the nth quarter of the disclosure year in question; and

\( CPI_{n-4} \) means forecast CPI for the equivalent quarter in the preceding disclosure year.

(6) For the purpose of subclause (5), 'forecast CPI' means CPI, unless CPI does not apply to the period in question, in which case it means the most recent CPI extended by-

(a) in the case of a quarter for which a forecast of the annual percent change in the headline CPI contained in the current Monetary Policy Statement issued by the Reserve Bank of New Zealand has been made, that forecast; and

(b) in respect of later quarters, a constant annual percent change equal to the arithmetic average of the values forecast in the most recent four quarters in respect of which a forecast described in paragraph (a) has been made.

(7) For the purpose of subclause (6), 'CPI' means-

(a) subject to paragraph (c), in respect of the December 2010 quarter and subsequent quarters, the consumer price index stipulated in the 'All Groups Index SE9A' as published by Statistics New Zealand;

(b) subject to paragraph (c) in respect of each quarter prior to the December 2010 quarter, the same index as described in paragraph (a) multiplied by 1.02; and

(c) in respect of quarters prior to any quarter in which the rate of GST is amended after this determination comes into force, the same index as
described in paragraph (a), multiplied by the Reserve Bank of New Zealand’s forecast change in that index (expressed as a decimal) arising from the amendment;

(8) For the purpose of subclause (7), 'GST' has the same meaning as defined in s YA 1 of the Income Tax Act 2007 as amended from time to time, and any equivalent legislation that supplements or replaces that definition.

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

(1) Each incremental change determined in accordance with clause 3.6.1 and incremental adjustment term is notionally carried forward, subject to clause 3.6.3, from the disclosure year in respect of which it is determined into each of the subsequent 5 disclosure years by applying the inflation rate.

(2) In each of the disclosure years into which an amount has been carried pursuant to subclause (1), a net balance must be determined by addition of-

(a) any incremental changes carried forward into that disclosure year from a preceding regulatory period; and

(b) any incremental adjustment term carried into that disclosure year.

3.6.3 Calculating gains and losses after a catastrophic event

Where-

(a) an IPP is amended pursuant to clause 3.7.5 by reason of a catastrophic event; and

(b) incremental changes calculated in the remaining disclosure years of the regulatory period in accordance with clauses 3.6.1(1) and 3.6.1(2) are negative,

clause 3.6.2(1) does not apply to those incremental changes.

SUBPART 7 Reconsideration of an individual price-quality path

3.7.1 Catastrophic event

Catastrophic event means an event-

(a) beyond the reasonable control of Transpower;

(b) that could not have been reasonably foreseen by Transpower at the time the most recent IPP determination was made; and

(c) in respect of which-

(i) action required to rectify its adverse consequences cannot be delayed until a future regulatory period without the grid outputs associated with the revenue-linked grid output measures being outside the range specified by the relevant cap or collar in the remaining disclosure years of the regulatory period;
(ii) remediation requires either or both of capital expenditure or operating expenditure during the regulatory period;
(iii) the full costs of remediation are not provided for in that IPP determination; and
(iv) the cost of remediation net of any insurance or compensatory entitlements would have an impact on the price path over the disclosure years of the IPP remaining on and after the first date at which a remediation cost is proposed to be or has been incurred, by an amount at least equivalent to 1% of the aggregated forecast MARs for the disclosure years of the IPP in which the cost was or will be incurred.

3.7.2 Change event

Change event means-

(a) change in a; or
(b) a new, legislative or regulatory requirement applying to Transpower the effect of which-
(c) must take place during the current regulatory period;
(d) is not explicitly or implicitly provided for in the IPP; and

will necessitate incursion of costs in response, which costs, over the disclosure years of the IPP remaining on and after the first date on which they are reasonably incurred, have an impact on the price path by an amount at least equivalent to 1% of the aggregated forecast MARs for the disclosure years of the IPP in which costs were or will be incurred.

3.7.3 Error

Error means incorrect data-

(a) discovered in an IPP determination and clearly unintended by the Commission to be included in it; or
(b) relied upon by the Commission in making or amending an IPP determination and clearly unintended by the Commission to be relied upon in making or amending it,

determined by the Commission to have an impact on the price path of an amount at least equivalent to 1% of the aggregated forecast MARs for the disclosure years of the IPP affected by the incorrect data.

3.7.4 When price-quality paths may be reconsidered

(1) Transpower’s IPP may be reconsidered where-

(a) the Commission considers; or
(b) Transpower satisfies the Commission, upon application,

that subclause (2) or (4) applies.

(2) This subclause applies if-
(a) subject to subclause (3), a catastrophic event has occurred;
(b) there has been error; or
(c) a change event has occurred.

(3) For the purpose of subclause (2)(a), where the costs to rectify the adverse consequences of a catastrophic event are fully covered by-
(a) the IPP (e.g. through an operating expenditure allowance for self-insurance); or
(b) commercial insurance held by Transpower,
the Commission will only reconsider the grid output targets, caps, collars and grid output incentive rates associated with revenue-linked grid output measures.

(4) This subclause applies if-
(a) false or misleading information relating to the making or amending of an IPP determination has been knowingly-
(i) provided by Transpower or any of its agents to the Commission; or
(ii) disclosed pursuant to an ID determination or information disclosure requirements under Subpart 3 of Part 4A of the Act, as continued in force by s 54W of the Act; and
(b) the Commission relied on that information in making an IPP determination.

(5) The Commission will reconsider by 30 November in each year of a regulatory period, subject to subclause (6), save the last, the IPP in respect of the remaining disclosure years commencing in the regulatory period to take account of-
(a) the revenue impact of major capex approved by the Commission;
(b) the revenue impact of the capital expenditure of any listed project approved for inclusion in the base capex allowance by the Commission in accordance with the processes set out in an IPP determination; and
(c) an EV adjustment,
on forecast MAR.

(6) For the purpose of subclause (5)-
(a) in respect of RCP1, the Commission will undertake the reconsideration described in that subclause only in the second and third disclosure years;
(b) 'major capex' has the same meaning as defined in the Capex IM; and
(c) 'EV adjustment' and 'listed project' have the same meanings as defined in an IPP determination.

3.7.5 Amending price-quality path after reconsideration

(1) Where, after reconsidering an IPP, the Commission determines that it should be amended, the Commission may amend either or both of the price path or the grid output targets, caps, collars and grid output incentive rates associated with revenue-linked grid output measures, subject to clause 3.7.4(3) and subclauses (2) and (3).
(2) The Commission must not amend the-
   (a) price path more than is reasonably necessary to take account of the change in costs net of any insurance or compensatory entitlements; and
   (b) grid output targets, caps, collars and grid output incentive rates associated with revenue-linked grid output measures more than are reasonably necessary to take into account any necessary change in quality,

   arising from-
   (c) the catastrophic event;
   (d) the change event;
   (e) error;
   (f) the provision of false or misleading information; or
   (g) the amendment required to forecast MAR to account for-
       (i) the revenue impact of major capex approved by the Commission; or
       (ii) the revenue impact of the base capex allowance of any listed project approved by the Commission; or
       (iii) an EV adjustment,

   as the case may be.

(3) Where the Commission’s reconsideration of the IPP was triggered by a catastrophic event, in determining the extent of the amendment required, the Commission will consider the extent to which Transpower has demonstrated that it has reviewed its capital expenditure and operating expenditure plans for the remainder of the regulatory period and made such substitutions as is possible without adversely affecting its ability to meet the grid output targets associated with revenue-linked grid output measures.
### SCHEDULE A  STANDARD PHYSICAL ASSET LIVES

#### Standard Physical Asset Lives for Transpower

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<tr>
<th>ASSET DESCRIPTION</th>
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<td>Transformers</td>
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<tr>
<td>Oil Containment</td>
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<td>22/11 kV Neutral Earthing Resistor</td>
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