

Attachment A: Overview of the Transpower incentive regime

Transpower capex input methodology review - Proposed focus areas for the capex IM review

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Expenditure category	When forecast expenditure is initially approved	Incentives – forecast amounts vs actual amounts	Incentive process mechanism	How incentive mechanism is initiated	Effect and timing of mechanism	Comments
Major capex (1)	Major capex may be approved at any time during an RCP	Effect of capex overspend	Major capex overspend adjustment (capex IM clause 3.3.7(1) and Schedule B4)	Transpower provides the information each year (IPP clause 23.1.3(l)) and the adjustment is determined by the Commission as an EV account entry which is applied to a later update of the forecast MAR	<ul style="list-style-type: none"> • Overspend incentive effect on Transpower is NPV negative • Total actual capex enters the RAB when assets are commissioned • An adjustment for the sum total of incentive adjustments on commissioned projects is given effect through the EV account in the IPP determination • The RAB value and incentive adjustment will only impact the forecast MAR in the RCP if the project is approved (and assets are commissioned) in the first 3 disclosure years of the RCP • Any balance in the EV account carried forward to a future forecast MAR in the current or next RCP is adjusted by the WACC rate 	This overspend incentive is a potential penalty calculated at the completion of a major capex project. Transpower bears 100% of costs in excess of total approved project costs
Major capex (2)	Major capex may be approved at any time during an RCP	Wash-up for actual vs forecast inputs to major capex (correction of overspend adjustment for disparity between forecast CPI/FX and actual CPI/FX)	Major capex overspend adjustment (capex IM clause 3.3.7(1) and Schedule B4 terms p and q)	Transpower provides the information each year (IPP clause 23.1.3(l)) and the overspend adjustment is determined by the Commission as an EV account entry which is applied to a later update of the forecast MAR	<ul style="list-style-type: none"> • The wash-up of forecast CPI and FX only applies if an overspend adjustment is required to be made at any stage during the RCP • Total actual capex enters the RAB when assets are commissioned (ie, based on actual CPI and FX) 	This mechanism ensures that the overspend adjustment is based on the actual CPI and FX values

Expenditure category	When forecast expenditure is initially approved	Incentives – forecast amounts vs actual amounts	Incentive process mechanism	How incentive mechanism is initiated	Effect and timing of mechanism	Comments
Major capex (3)	Major capex may be approved at any time during an RCP	Effect of capex underspend	Major capex efficiency adjustment (if cost decreases are due to efficiency gains) (capex IM clause 4.1.1 and Schedule B7)	Transpower may apply for an efficiency adjustment (capex IM clause 4.1.1(1)) and the adjustment is determined by the Commission as an EV account entry which is applied to a later forecast MAR (capex IM clause 4.1.1(1))	<ul style="list-style-type: none"> • Efficiency incentive effect on Transpower is NPV positive • Total actual capex enters the RAB when assets are commissioned • The incentive adjustment is given effect through the EV account in the IPP determination • The determination of the adjustment is carried out after the end of the RCP • This incentive adjustment will only impact the forecast MAR in the next RCP • Any balance in the EV account is carried forward to a future forecast MAR in the next RCP, and is adjusted by the WACC rate 	The Commission will calculate a value for net efficiency once per RCP. The major capex incentive rate is 33%. This is the only major capex adjustment that applies to the portfolio of major capex projects as a whole
Major capex (4)	Major capex may be approved at any time during an RCP	Wash-up for forecast vs actual capex amounts applied in the forecast MAR in the price-quality path	Annual wash-up of the forecast MAR (IPP clause 22.1.1 and Schedule D for the setting of forecast major capex in the forecast MAR, and clause 21.1.3 and Schedule E for the application of actual major capex in the wash-up of the forecast MAR)	Transpower provides the information each year to enable the Commission to determine an update of the forecast MAR that takes account of the forecast MAR wash-up in respect of a preceding year (IPP clauses 9, 22 and 24)	<ul style="list-style-type: none"> • Total actual capex enters the RAB when assets are commissioned • The annual wash-up is given effect through the EV account in the IPP determination • The RAB value and wash-up adjustment will only impact the forecast MAR in the RCP if the assets are commissioned in the first 3 disclosure years of the RCP • Any balance in the EV account carried forward to a future forecast MAR in the current or next RCP is adjusted by the WACC rate 	The effect of the wash-up of forecast vs actual capex values means Transpower's revenue over time is adjusted to reflect actual major capex on an NPV basis

Expenditure category	When forecast expenditure is initially approved	Incentives – forecast amounts vs actual amounts	Incentive process mechanism	How incentive mechanism is initiated	Effect and timing of mechanism	Comments
Major capex (5)	Major capex may be approved at any time during an RCP	Effect of differences in capex project outputs	Major capex project output adjustment (capex IM clause 3.3.7(2) and Schedule B5)	Transpower provides the information each year (IPP clause 23.1.3(m)), with the adjustment determined by the Commission as an EV account entry which is applied to a later update of the forecast MAR	<ul style="list-style-type: none"> • Output incentive effect on Transpower is NPV negative • Total actual capex enters the RAB when assets are commissioned • An adjustment for the sum total of incentive adjustments on commissioned projects is given effect through the EV account in the IPP determination • The incentive adjustment will only impact the forecast MAR in the RCP if the project is approved (and assets are commissioned) in the first 3 disclosure years of the RCP • Any balance in the EV account carried forward to a future forecast MAR in the current or next RCP is adjusted by the WACC rate 	This adjustment is a penalty if Transpower does not deliver the agreed-upon project outputs. The major capex incentive rate is 33%
Major capex (6)	Major capex may be approved at any time during an RCP	Effect of differences in approved major capex project (major capex allowance, maximum recoverable costs, recovery scheme for recoverable costs, approved major capex project outputs or approval expiry date)	Transpower may apply for an amendment to an approved investment (capex IM clauses 3.3.4(1) and 7.4.2)	Transpower may apply up until the end of September following the disclosure year in which the major capex project is commissioned (or six weeks prior to the approval expiry date in the case of the approval expiry date) for the Commission to approve the project to be amended	<ul style="list-style-type: none"> • The incentive effect on Transpower is NPV positive • Total actual capex enters the RAB when assets are commissioned • Amended forecast capex is washed up under the capex wash-up mechanism • Any approved amended project values are applied for the purposes of the incentive mechanisms (eg, overspend, efficiency or outputs) and the wash-up mechanism 	Allows Transpower to amend approved projects that may have been approved well in advance of construction, and where the actual costs and timing of the investment become clear

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Major capex (7)	Major capex may be approved at any time during an RCP	Project started but never commissioned (ie, capex does not enter the RAB)	Major capex sunk costs adjustment (capex IM, clauses 3.3.5(1), 6.1.1(6) and Schedule B6)	Transpower may apply prior to the commissioning date of a major capex project for a sunk costs adjustment and provide the necessary information each year (IPP clause 23.1.3(n)) and the Commission may calculate and approve the adjustment as an EV account entry which is applied to a later update of the forecast MAR	<ul style="list-style-type: none"> • The incentive effect on Transpower is NPV positive • Actual commissioned capex enters the RAB when assets are commissioned (excludes any amount not commissioned by virtue of this adjustment) • Amended forecast capex is washed up under the wash-up mechanism • An adjustment for the sum total of incentive adjustments on sunk cost projects is given effect through the EV account in the IPP determination • Any balance in the EV account carried forward to a future forecast MAR in the current or next RCP is adjusted by the WACC rate 	Allows Transpower to avoid being exposed to costs where a major capex project is wholly or partially abandoned for a good reason
Major capex (8)	Major capex may be approved at any time during an RCP	Project does not proceed	Transpower may apply for an amendment to an approved investment (capex IM clauses 3.3.4(1) and 7.4.2)	Transpower may apply up until six weeks prior to the approval expiry date for the Commission to approve the project to be amended	<ul style="list-style-type: none"> • Actual commissioned capex enters the RAB when assets are commissioned (excludes any amount not commissioned by virtue of this adjustment) • Forecast capex for a project that does not proceed is washed up under the capex wash-up mechanism • Any approved amended project values are applied for the purposes of the incentive mechanisms (eg, overspend, efficiency or outputs) and the wash-up mechanism 	
Major capex (9)	Major capex may be approved at any time during an RCP	Effect of changes in Transpower's policies and processes	Not applicable – applies to base capex only	Not applicable – applies to base capex only	Not applicable – applies to base capex only	Major capex projects have no adjustment for changes in policies and processes (base capex does)

Expenditure category	When forecast expenditure is initially approved	Incentives – forecast amounts vs actual amounts	Incentive process mechanism	How incentive mechanism is initiated	Effect and timing of mechanism	Comments
Base capex (1)	The base capex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Effect of capex overspend	Annual base capex expenditure adjustment (capex IM clause 3.2.3(1)(a) and Schedule B1)	Transpower provides the information each year (IPP clause 23.1.3(j)), and the adjustment is determined by the Commission as an EV account entry which is applied to a later forecast of the forecast MAR	<ul style="list-style-type: none"> • The overspend incentive effect on Transpower is NPV negative • Total actual capex enters the RAB when assets are commissioned • An adjustment for the sum total of incentive adjustments on commissioned projects is given effect through the EV account in the IPP determination • The RAB value and incentive adjustment will only impact the forecast MAR in the RCP if the project is approved (and assets are commissioned) in the first 3 disclosure years of the RCP • Any balance in the EV account carried forward to a future forecast MAR in the current or next RCP is adjusted by the WACC rate 	The 33% base capex incentive rate applies to both over- and under-spends, ie, Transpower retains or bears 33% of any savings or overspends in base capex
Base capex (2)	The base capex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Effect of capex underspend	Annual base capex expenditure adjustment (capex IM clause 3.2.3(1)(a) and Schedule B1)	Transpower provides the information each year (IPP clause 23.1.3(j)), and the adjustment is determined by the Commission as an EV account entry which is applied to a later forecast of the forecast MAR	<ul style="list-style-type: none"> • The underspend incentive effect on Transpower is NPV positive • Total actual capex enters the RAB when assets are commissioned • An adjustment for the sum total of incentive adjustments on commissioned projects is given effect through the EV account in the IPP determination • The RAB value and incentive adjustment will only impact the forecast MAR in the RCP if the assets are commissioned in the first 3 disclosure years of the RCP • Any balance in the EV account carried forward to a future forecast MAR in the current or next RCP is adjusted by the WACC rate 	The 33% base capex incentive rate applies to both over- and under-spends, ie, Transpower retains or bears 33% of any savings or overspends in base capex

Expenditure category	When forecast expenditure is initially approved	Incentives – forecast amounts vs actual amounts	Incentive process mechanism	How incentive mechanism is initiated	Effect and timing of mechanism	Comments
Base capex (3)	The base capex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Wash-up for actual vs forecast expenditure (correction of overspend/underspend adjustments for disparity between forecast CPI/FX and actual CPI/FX)	Annual base capex expenditure adjustment (capex IM clause 3.2.3(1)(a) and Schedule B1, terms 'e' and 'f')	Transpower provides the information each year (IPP clause 23.1.3(j)), and the adjustment is determined by the Commission as an EV account entry which is applied to a later forecast of the forecast MAR	<ul style="list-style-type: none"> Total actual capex enters the RAB when assets are commissioned (ie, based on actual CPI and FX) 	This adjustment ensures that the overspend and underspend adjustments are based on the actual CPI and FX values
Base capex (4)	The base capex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Wash-up for forecast vs actual capex amounts applied in the forecast MAR in the price-quality path	Annual wash-up of the forecast MAR (IPP Schedule D for the setting of forecast base capex in the forecast MAR, and clauses 21.1.1, 21.1.3 and Schedule E for the application of actual base capex in the wash-up of the forecast MAR)	Transpower provides the information each year to enable the Commission to determine an update of the forecast MAR that takes account of the forecast MAR wash-up in respect of a preceding year (IPP clauses 9, 22 and 24)	<ul style="list-style-type: none"> Total actual capex enters the RAB when assets are commissioned The annual wash-up is given effect through the EV account in the IPP determination The RAB value and wash-up adjustment will only impact the forecast MAR in the RCP if the assets are commissioned in the first 3 disclosure years of the RCP Any balance in the EV account carried forward to a future forecast MAR in the current or next RCP is adjusted by the WACC rate 	The effect of the wash-up of forecast vs actual capex values means Transpower's revenue over time is adjusted to reflect actual base capex on an NPV basis
Base capex (5)	The base capex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Effect of differences in capex project outputs	Grid output adjustments (capex IM clause 3.2.3(1)(c) and Schedule B3)	Transpower proposes grid output measures for Commission approval prior to the RCP, Transpower provides the information each year (IPP clause 23.1.3(i)), and the adjustment is determined by the Commission as an EV account entry which is applied to a later forecast of the forecast MAR	<ul style="list-style-type: none"> The output incentive effect on Transpower can be NPV positive or negative within the range of the cap and collar for each grid output measure An adjustment for the sum total of incentive adjustments is given effect through the EV account in the IPP determination The incentive adjustment will only impact the forecast MAR in the RCP if they are made in respect of the first 3 disclosure years of the RCP 	This is a symmetric incentive (ie, applies a penalty for underperformance and rewards performance over targets up to the cap in each case)

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Base capex (6)	The base capex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Effect of expenditure differences in project on which the approved base capex allowance was based	None	N/A	N/A	When the base capex allowance is approved, Transpower has discretion on how to use the allowance
Base capex (7)	The base capex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Project started but never commissioned (does not enter the RAB)	None	N/A	N/A	Transpower is not compensated for sunk costs (in comparison with the sunk cost adjustment for major capex projects). Costs must be absorbed within the opex allowance or by the shareholder
Base capex (8)	The base capex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Project does not proceed	None	N/A	N/A	Approved base capex can be applied towards other projects. Transpower is not compensated for opex sunk costs incurred in planning for the project. Those costs must be absorbed within the opex allowance or by the shareholder
Base capex (9)	The base capex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Effect of changes in Transpower's policies and processes	Annual base capex policies and processes adjustment (capex IM clause 3.2.3(1)(b) and Schedule B2)	Transpower provides the information each year (IPP clause 23.1.3(k)), and the adjustment is determined by the Commission as an EV account entry which is applied to a later forecast of the forecast MAR	<ul style="list-style-type: none"> The policies and processes incentive effect on Transpower is NPV negative The incentive adjustment is given effect annually through the EV account in the IPP determination The incentive adjustment will only impact the forecast MAR in the RCP if it is made in respect of the first 3 disclosure years of the RCP 	The adjustment is an asymmetric penalty, with an incentive rate of 33%

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Listed projects base capex (1)	Qualifies for inclusion as listed project before the commencement of the RCP, and an addition to the base capex expenditure allowance is able to be approved during RCP	Effect of capex overspend				This is the same as for any other base capex project once there is an approved additional base capex allowance (capex IM Schedule B1, clause 1.1.5(2) definition of 'adjusted base capex allowance' and clause 3.2.4(4))
Listed projects base capex (2)	Qualifies for inclusion as listed project before the commencement of the RCP, and an addition to the base capex expenditure allowance is able to be approved during RCP	Effect of capex underspend				This is the same as for any other base capex project once there is an approved additional base capex allowance (capex IM Schedule B1, clause 1.1.5(2) definition of 'adjusted base capex allowance' and clause 3.2.4(4))
Listed projects base capex (3)	Qualifies for inclusion as listed project before the commencement of the RCP, and an addition to the base capex expenditure allowance is able to be approved during RCP	Wash-up for actual vs forecast inputs to base capex (correction of overspend and underspend adjustments for disparity between forecast CPI/FX and actual CPI/FX)				This is the same as for any other base capex project once there is an approved additional base capex allowance. Forecast CPI and forecast FX values for an approved additional base capex allowance are to be the same as when setting the base capex allowance prior to the RCP (capex IM Schedule B1, clause 1.1.5(2) definition of 'adjusted base capex allowance' and clause 3.2.4(5))

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Listed projects base capex (4)	Qualifies for inclusion as listed project before the commencement of the RCP, and an addition to the base capex expenditure allowance is able to be approved during RCP	Wash-up for forecast vs actual capex amounts applied in the forecast MAR in the price-quality path				This is the same as for any other base capex project once there is an approved additional base capex allowance (capex IM Schedule B1, clause 1.1.5(2) definition of 'adjusted base capex allowance' and clause 3.2.4(4))
Listed projects base capex (5)	Qualifies for inclusion as listed project before the commencement of the RCP, and an addition to the base capex expenditure allowance is able to be approved during RCP	Effect of differences in grid outputs				For an approved listed project this is the same as for any other base capex project once the listed project has an approved additional base capex allowance

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Listed projects base capex (6)	Qualifies for inclusion as listed project before the commencement of the RCP, and an addition to the base capex expenditure allowance is able to be approved during RCP	Effect of differences in listed project	No expenditure allowance is set before the RCP (capex IM clause 2.2.3), application for approval of expenditure may be made up to 22 months before the end of the RCP (capex IM clause 3.2.4(1)), additional expenditure allowance is evaluated and approved by the Commission during the RCP (clause 3.2.4(4))	Transpower may submit an application for approval of additional base capex allowance for a project already listed in the IPP (capex IM clause 3.2.4 (1) and (2) and IPP Schedule I)	Transpower price path is reconsidered in the annual update of the forecast MAR to take into account the revenue effect of the forecast commissioning of any approved additional base capex (Transpower IM clauses 3.7.4(5) and 3.7.5(2)(g)(ii))	The price path reconsideration takes into account in an RCP any forecast commissioning of approved additional listed project capex. Once the additional base capex allowance is approved, Transpower has discretion on how to apply the additional base capex allowance
Listed projects base capex (7)	Qualifies for inclusion as listed project before the commencement of the RCP, and an addition to the base capex expenditure allowance is able to be approved during RCP	Project started but never commissioned (ie, capex does not enter the RAB)	None	N/A	N/A	Transpower is not compensated for sunk costs (compared with sunk cost adjustment for major capex projects). Costs must be absorbed within the opex allowance or by the shareholder

Expenditure category	When forecast expenditure is initially approved	Incentives – forecast amounts vs actual amounts	Incentive process mechanism	How incentive mechanism is initiated	Effect and timing of mechanism	Comments
Listed projects base capex (8)	Qualifies for inclusion as listed project before the commencement of the RCP, and an addition to the base capex expenditure allowance is able to be approved during RCP	Project does not proceed	None	N/A	N/A	Approved base capex can be applied towards other projects. Transpower is not compensated for opex sunk costs incurred in planning for the project. Those costs must be absorbed within the opex allowance or by the shareholder
Listed projects base capex (9)	Qualifies for inclusion as listed project before the commencement of the RCP, and an addition to the base capex expenditure allowance is able to be approved during RCP	Effect of changes in Transpower's policies and processes	For an approved listed project this is the same as for any other base capex project once the listed project has an approved additional base capex allowance			
Opex (1)	The opex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Effect of opex overspend	IRIS incentive (Transpower IM clauses 3.6.1 and 3.1.3(1)(a))	Transpower must calculate an opex incentive amount for each disclosure year of RCP3 based on the opex performance in RCP2, which will be treated as a recoverable cost in the price-quality path	<ul style="list-style-type: none"> The incentive is NPV negative 	

Expenditure category	When forecast expenditure is initially approved	Incentives – forecast amounts vs actual amounts	Incentive process mechanism	How incentive mechanism is initiated	Effect and timing of mechanism	Comments
Opex (2)	The opex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Effect of opex underspend	IRIS (Transpower IM Determination: Part 3, subpart 6)	Transpower must calculate an opex incentive amount for each disclosure year of RCP3 based on the opex performance in RCP2, which will be treated as a recoverable cost in the price-quality path	<ul style="list-style-type: none"> The incentive is NPV positive 	
Opex (3)	The opex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Wash-up for actual vs forecast expenditure (correction of overspend/underspend adjustments for disparity between forecast CPI/FX and actual CPI/FX)	No adjustment is made for actual expenditure, but the opex allowance for the purpose of the IRIS incentive is adjusted to reflect actual CPI and FX values for the purposes of the IRIS incentive calculation (IPP clause 11.2)	Transpower must calculate an IRIS opex incentive amount for each disclosure year of RCP3 based on the opex performance in RCP2, which will be treated as a recoverable cost in the price-quality path	<ul style="list-style-type: none"> The IRIS incentive amount can be NPV positive or NPV negative 	When the opex allowance is approved, Transpower has the discretion on how to use the allowance
Opex (4)	The opex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Wash-up for forecast vs actual opex amounts applied in the forecast MAR in the price-quality path	None	N/A	N/A	When the opex allowance is approved, Transpower has the discretion on how to use the allowance
Opex (5)	The opex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Effect of output differences in project on which the approved opex allowance was based	Grid output adjustments (capex IM clause 3.2.3(1)(c) and Schedule B3)	Transpower proposes grid output measures for Commission approval prior to the RCP, Transpower provides the information each year (IPP clause 23.1.3(i)) and the adjustment is determined by the Commission as an EV account entry which is applied to a later forecast of the forecast MAR	<ul style="list-style-type: none"> The output incentive effect on Transpower can be NPV positive or negative within the range of the cap and collar for each grid output measure An adjustment for the sum total of incentive adjustments is given effect through the EV account in the IPP determination The incentive adjustment will only impact the forecast MAR in the RCP if they are made in respect of the first 3 disclosure years of the RCP 	When the opex allowance is approved, Transpower has the discretion on how to use the allowance

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Opex (6)	The opex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Effect of expenditure differences in project on which the approved opex allowance was based	None	N/A	N/A	When the opex allowance is approved, Transpower has the discretion on how to use the allowance
Opex (7)	The opex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Project started but never completed	None	N/A	N/A	When the opex allowance is approved, Transpower has the discretion on how to use the allowance. Transpower is not separately compensated for already incurred opex. These costs must be absorbed within the opex allowance or by the shareholder
Opex (8)	The opex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Project does not proceed	None	N/A	N/A	When the opex allowance is approved, Transpower has the discretion on how to use the allowance
Opex (9)	The opex allowance applicable to each year of the RCP is set by the Commission prior to the start of the RCP	Effect of changes in Transpower's policies and processes	None	N/A	N/A	When the opex allowance is approved, Transpower has the discretion on how to use the allowance