Incremental Rolling Incentive Scheme Input Methodology Amendments Determination 2014

[2014] NZCC 32


Date of Decision: 27 November 2014

The Commission: Energy Division Transpower Division
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Regulation Branch, Commerce Commission
Wellington, NEW ZEALAND
27 November 2014
Pursuant to Part 4 of the Commerce Act 1986 (the Act) the Commerce Commission makes the following determination:

1. **DETERMINATIONS AMENDED**

This determination amends the following determinations, as previously amended:

(a) *Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26* (the *EDB IM Determination*); and

(b) *Transpower Input Methodologies Determination [2012] NZCC 17* (the *Transpower IM Determination*).

2. **COMMENCEMENT**

2.1 This determination comes into force on the date on which notice of the determination is given in the New Zealand Gazette in accordance with section 52W of the Commerce Act 1986.

2.2 Changes made to input methodologies by this determination do not apply to any:

(a) default or customised price-quality path; or

(b) individual price-quality path;

applying at the date this determination comes into force.

3. **INTERPRETATION**

3.1 Terms in bold type have the meaning given to those terms in the applicable Determination. Terms in bold type used in this determination that are defined in the Act, but not this determination, have the same meaning as in the Act.

3.2 Nothing in this determination limits the Commission’s authority to amend any Determination in accordance with the Act.

4. **EDB IM AMENDMENTS**

4.1 In the *EDB IM Determination*, insert the following definitions in clause 1.1.4(2) in alphabetical order:

"adjustment to the opex incentive" means the amount calculated in accordance with clause 3.3.4(2);  

"actual opex" has the meaning specified in clause 3.3.3(9);
“amount carried forward means, for any given disclosure year, the amount determined in accordance with clause 3.3.3;

“capex incentive amount means the amount determined in accordance with clause 3.3.7(2);

“forecast opex has the meaning specified in clause 3.3.3(8);

“IRIS incentive adjustment means the recoverable cost amount determined under clause 3.3.1(2);

“opex incentive amount means the amount determined in accordance with clause 3.3.2(2);

“retention factor means the percentage amount determined by the Commission in a CPP determination or DPP determination for the purpose of calculating the capex incentive amount;”.

4.2 In the EDB IM Determination, replace clause 3.1.3(1)(a) with:

“(a) any amount that is—

“(i) an IRIS incentive adjustment calculated in respect of a non-exempt EDB; or

“(ii) a positive net balance determined in accordance with clause 3.3.12(2), provided that any requirements pursuant to an ID determination regarding auditor certification of any value determined in accordance with Section 3 of Subpart 3 have been met;”.

4.3 In the EDB IM Determination:

(a) replace “clause 3.3.1(5)” in the definition of ‘inflation rate’ in clause 1.1.4(2) with “clause 3.3.12(5)”;

(b) renumber clauses 3.3.1 to 3.3.3 as clauses 3.3.12 to 3.3.14 respectively and include under the heading “SECTION 5 Transitional provisions”;

(c) insert “commencing prior to 27 November 2014” after “CPP regulatory period” in renumbered subclauses 3.3.12(1), (2), (3) and (4); and

(d) make consequential amendments to other clause number references in relation to the above matters.

4.4 In the EDB IM Determination, insert the following in Subpart 3 of Part 3:

“SECTION 1 Annual IRIS incentive adjustments

“3.3.1 Calculation of annual IRIS incentive adjustment as recoverable cost
“(1) A non-exempt EDB must calculate an IRIS incentive adjustment for each disclosure year of each regulatory period.

“(2) The ‘IRIS incentive adjustment’ is the amount determined in accordance with the formula—

\[ \text{opex incentive amount} + \text{capex incentive amount}. \]

SECTION 2  Operating expenditure incentives

3.3.2 How to calculate opex incentive amounts

“(1) An opex incentive amount must be calculated for each disclosure year of a regulatory period, subject to subclause (3).

“(2) The ‘opex incentive amount’ for a disclosure year is an amount equal to the sum of—

“(a) all amounts carried forward into that disclosure year from a disclosure year in a preceding regulatory period; and

“(b) where applicable under clause 3.3.4(1), an adjustment to the opex incentive for that disclosure year.

“(3) An opex incentive amount shall not be calculated:

“(a) by Orion New Zealand Limited, for any disclosure year in a regulatory period commencing on, or prior to, 1 April 2020; and

“(b) by any other EDB, for any disclosure year commencing prior to 1 April 2020.

3.3.3 How to calculate the amount carried forward to subsequent disclosure years

“(1) An ‘amount carried forward’ must be calculated for each disclosure year of a regulatory period, subject to subclause (6).

“(2) The ‘amount carried forward’ for the first disclosure year of a regulatory period, including the first disclosure year following expiration of a CPP determination applicable to the EDB, subject to subclause (5), is calculated in accordance with the formula—

\[ \text{forecast opex}_t - \text{actual opex}_t, \]

where—

\[ t \] means the disclosure year in question.
"(3) The ‘amount carried forward’ for a disclosure year that is not the first or last disclosure year of a regulatory period is calculated in accordance with the formula—

$$(\text{forecast opex}_t - \text{actual opex}_t) - (\text{forecast opex}_{t-1} - \text{actual opex}_{t-1})$$

where—

$t$ means the disclosure year in question; and

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

"(4) The ‘amount carried forward’ for the last disclosure year of a regulatory period is nil.

"(5) Where an EDB is subject to a DPP determination for no more than one consecutive disclosure year of the DPP regulatory period, the ‘amount carried forward’ for that disclosure year is nil.

"(6) An amount carried forward shall not be calculated:

"(a) by Orion New Zealand Limited, for any disclosure year commencing prior to 1 April 2019; and

"(b) by any other EDB, for any disclosure year commencing prior to 27 November 2014.

"(7) Each amount carried forward is notionally carried forward from the disclosure year in respect of which it is calculated into each of the subsequent 5 disclosure years.

"(8) ‘Forecast opex’, subject to clauses 3.3.13 and 3.3.14, is, for a disclosure year—

"(a) in a DPP regulatory period applying to an EDB for which starting prices applicable to the EDB were determined by the Commission under s 53P(3)(b) or s 53X(2), the amount of forecast operating expenditure specified by the Commission for the relevant disclosure year in the DPP determination for the purpose of calculating an opex incentive amount; or

"(b) in a DPP regulatory period applying to an EDB for which the prices applicable to the EDB were the prices that applied at the end of the preceding DPP regulatory period or CPP regulatory period, the amount of forecast operating expenditure specified by the Commission in the DPP determination or otherwise notified to the EDB by the Commission.
‘Actual opex’ is the amount of operating costs allocated to electricity distribution services for the relevant disclosure year calculated in accordance with Part 2.

3.3.4 How to calculate the adjustment to the opex incentive for the second year of a regulatory period

(1) An adjustment to the opex incentive must be calculated for the second disclosure year of a DPP regulatory period (including a DPP regulatory period that has been amended by a quality standard variation CPP) applicable to the EDB.

(2) The ‘adjustment to the opex incentive’, where the starting prices for the current DPP regulatory period are—

(a) determined by the Commission in accordance with s 53P(3)(b) of the Act, is an amount equal to the ‘base year adjustment term’ calculated in accordance with clause 3.3.5; and

(b) the prices that applied at the end of the preceding DPP regulatory period or CPP regulatory period, is an amount calculated in accordance with the formula—

base year adjustment term + roll-over adjustment term

where—

base year adjustment term means the amount calculated in accordance with clause 3.3.5; and

roll-over adjustment term means the amount calculated in accordance with clause 3.3.6.

3.3.5 How to calculate the base year adjustment term

A ‘base year adjustment term’ is calculated in accordance with the formula—

\[
\left( \frac{\text{forecast opex}_{t-1} - \text{actual opex}_{t-1} - (\text{forecast opex}_{t-2} - \text{actual opex}_{t-2})}{(1 + \text{WACC})^t} \right)
\]

where—

WACC means the WACC as determined by the Commission and applicable to the EDB’s current DPP

t-1 means the disclosure year immediately prior to the current regulatory period; and

t-2 means the disclosure year commencing two years prior to the current regulatory period.
3.3.6 How to calculate the roll-over adjustment term

A 'roll-over adjustment term' is calculated in accordance with the formula –

\[
\text{Actual opex}_{t-2} - \text{Forecast opex}_t \times \frac{(1-(1+WACC)^6)/WACC \times (1+WACC)^2}{WACC}
\]

where –

- \( WACC \) means the WACC as determined by the Commission and applicable to the EDB's current DPP;
- \( t \) means the first disclosure year of the current regulatory period; and
- \( t-2 \) means the disclosure year commencing two years prior to the current regulatory period.

SECTION 3 Capital expenditure incentives

3.3.7 How to calculate capex incentive amounts

(1) A capex incentive amount must be calculated for each disclosure year of a DPP regulatory period irrespective of whether the EDB in question is subject to a CPP or a DPP during that DPP regulatory period, subject to subclause (3).

(2) The 'capex incentive amount' for a disclosure year is –

(a) the amount calculated in accordance with the following formula for a disclosure year in the DPP regulatory period other than the first disclosure year –

\[
\left(\frac{\text{capex wash-up} + \text{retention adjustment}}{l - 1}\right) \times (1 + r)^{y+0.5}
\]

where –

- \( l \) is the number of disclosure years in the DPP regulatory period;
- \( r \) is the cost of debt applying to the DPP or CPP in question; and
- \( y \) is the number of disclosure years preceding the disclosure year in question in the DPP regulatory period; and
(b) nil-

(i) for the first disclosure year of the DPP regulatory period; and

(ii) for a disclosure year in a DPP regulatory period which commences prior to 1 April 2020.

(3) A capex incentive amount shall not be calculated:

(a) by Orion New Zealand Limited, for any disclosure year in a regulatory period commencing on, or prior to, 1 April 2020; and

(b) by any other EDB, for any disclosure year in a DPP regulatory period commencing prior to 1 April 2020.

3.3.8 How to calculate the capex wash-up

(1) The ‘capex wash-up’ is an amount equal to the present value of the differences in the series of building block allowable revenues before tax for the preceding DPP regulatory period, subject to subclause (2) and clauses 3.3.10 and 3.3.11, from adopting—

(a) the sum of the value of commissioned assets for each disclosure year of that preceding DPP regulatory period,

Instead of—

(b) for each disclosure year of the preceding DPP regulatory period in which the EDB was subject to a DPP, the forecast aggregate value of commissioned assets determined by the Commission in respect of those disclosure years; and

(c) for each disclosure year of the preceding DPP regulatory period in which the EDB was subject to a CPP, the sum of the forecast value of commissioned assets determined by the Commission in respect of those disclosure years.

(2) For the purpose of subclause (1)—

(a) the present value must be determined by discounting the building block allowable revenues before tax to the end of the preceding DPP regulatory period using a discount rate equal to the WACC applied by the Commission in setting prices for each disclosure year for the relevant DPP or CPP in the preceding DPP regulatory period;

(b) the series of building block allowable revenues before tax for each disclosure year of the preceding DPP regulatory period must—
"(i) be calculated using the same methodology that was applied by the Commission in setting starting prices for the EDB for the relevant DPP or CPP, subject to subparagraphs (ii) and (iii);

"(ii) for the purpose of subparagraph (i), adopt the sum of depreciation calculated under Part 2 in respect of each disclosure year for assets having a commissioning date in the preceding DPP regulatory period; and

"(iii) for the purpose of subparagraph (i), adopt the same values for all other inputs to the calculation of building block allowable revenues before tax; and

"(c) where building block allowable revenues before tax from adopting the sum of value of commissioned assets exceed the building block allowable revenues before tax from using the forecast values of commissioned assets (as determined using the forecast aggregate value of commissioned assets for each disclosure year in which the EDB was subject to a DPP and sum of the forecast value of commissioned assets for each disclosure year in which the EDB was subject to a CPP) then the difference is a positive amount of capex wash-up; and

"(d) where building block allowable revenues before tax from adopting the sum of value of commissioned assets is less than the building block allowable revenues before tax from using the forecast value of commissioned assets (as determined using the forecast aggregate value of commissioned assets for each disclosure year in which the EDB was subject to a DPP and sum of the forecast value of commissioned assets for each disclosure year in which the EDB was subject to a CPP) then the difference is a negative amount of capex wash-up.

"3.3.9 How to calculate the retention adjustment

"(1) The ‘retention adjustment’ is calculated in accordance with the formula—

\[(PV \text{ of forecast commissioned asset values} - PV \text{ of actual commissioned asset values}) \times \text{retention factor}.\]

"(2) ‘PV of forecast commissioned asset values’ is an amount equal to the sum of—

"(a) the present value, as at the end of the preceding DPP regulatory period, of the forecast aggregate value of commissioned assets for each disclosure year of the preceding DPP regulatory period for which the EDB was subject to a DPP; and

"(b) the present value, as at the end of the preceding DPP regulatory period, of the sum of the forecast value of commissioned assets for...
each disclosure year of the preceding DPP regulatory period for which the EDB was subject to a CPP.

“(3) ‘PV of actual commissioned asset values’ is the present value, as at the end of the preceding DPP regulatory period, of the value of commissioned asset calculated in accordance with Part 2 for every asset that was commissioned during the preceding DPP regulatory period.

“SECTION 4 Price-quality path amendments and other events

“3.3.10 Calculating incentive adjustments for price-quality path amendments

“Where a price-quality path is amended following–

“(a) a catastrophic event;

“(b) a change event;

“(c) an error; or

“(d) provision of false or misleading information under clause 4.5.4(1)(e) or 5.6.4(4),

the forecast opex and forecast aggregate value of commissioned assets required to be used by the EDB to calculate the amount carried forward for the disclosure year in which the event occurred and each subsequent disclosure year prior to the effective date of the amendment to the price-quality path, is the amount specified by the Commission in the amended DPP determination or CPP determination.

“3.3.11 Calculating incentive adjustments for other events

“Where an event that is–

“(a) an amalgamation;

“(b) a merger (as defined in a DPP determination);

“(c) a major transaction (as defined in a DPP determination); or

“(d) an alteration to Part 2 or ID determination requirements affecting the quantification of operating costs allocated to electricity distribution services or a value of commissioned asset,

“occurs in a disclosure year and–

“(e) the Commission considers; or

“(f) the EDB in question satisfies the Commission upon application,
“that the event has, or is likely to have, a material effect on the calculation of the opex incentive amount or capex incentive amount that would otherwise have been required to be calculated by the EDB then—

“(g) the forecast opex; and

“(h) either—

“(i) forecast aggregate value of commissioned assets; or

“(ii) sum of the forecast value of commissioned assets,

“required to be used by the EDB to calculate the amount carried forward for that disclosure year and each subsequent disclosure year in the regulatory period may be determined by the Commission, and notified to the EDB, in order to preserve, to the extent appropriate—

“(i) the correct outcomes for expenditure efficiencies achieved before the event; and

“(j) the relevant incentive properties after the event.”

4.5 In the EDB IM Determination, delete subparagraph 5.3.1(a), renumbering subsequent subparagraphs accordingly.
5. **TRANSPOWER IM AMENDMENTS**

5.1 In the Transpower IM Determination, insert the following definitions in clause 1.1.4(2) in alphabetical order:

   "**actual opex** has the meaning specified in clause 3.6.3(8);

   "**adjustment to the opex incentive** means the amount calculated in accordance with clause 3.6.4(1);

   "**amount carried forward** means, for any given disclosure year, the amount determined in accordance with clause 3.6.3;

   "**forecast opex** has the meaning specified in clause 3.6.3(7);

   "**opex incentive amount** means the amount determined in accordance with clause 3.6.2;".

5.2 In the Transpower IM Determination:

   (a) replace "clause 3.6.1(5)" in the definition of 'inflation rate' in clause 1.1.4(2) with "clause 3.6.6(5)";

   (b) replace "clause 3.6.1(4)" in the definition of 'incremental adjustment term' in clause 1.1.4(2) with "clause 3.6.6(4)";

   (c) renumber clauses 3.6.1 to 3.6.3 as clauses 3.6.6 to 3.6.8 respectively and include under the heading 'SECTION 3 Transitional provisions';

   (d) replace "an opening year" in renumbered clause 3.6.6(1) with "the opening year of RCP1";

   (e) replace "the regulatory period" in renumbered clauses 3.6.6(2), 3.6.6(3) and 3.6.8(b) with "RCP1";

   (f) replace "every regulatory period except RCP1" in renumbered clause 3.6.6(4)(a) with "RCP2";

   (g) replace "the preceding regulatory period" in the definitions of the variables t-1 and t-2 in renumbered clause 3.6.6(4) with "RCP1";

   (h) insert the following as clause 3.6.6(9):

   "For the purpose of this Subpart, RCP2 means the regulatory period commencing on 1 April 2015 and ending on 31 March 2020."

   (i) replace "a preceding regulatory period" in renumbered clause 3.6.7(2)(a) with "RCP1"; and
(j) make consequential amendments to other clause number references in relation to the above matters.

5.3 In the Transpower IM Determination, replace clause 3.1.3(1)(a) with:

“(a) any amount that is—

“(i) an opex incentive amount; or

“(ii) a positive net balance determined in accordance with clause 3.6.7(2), provided that any requirements pursuant to an ID determination regarding auditor certification of any value determined in accordance with that clause have been met;”.

5.4 In the Transpower IM Determination, insert the following in subpart 6 of Part 3:

“SECTION 1 Annual IRIS incentive amounts for operating expenditure

“3.6.1 Calculation of annual IRIS incentives for operating expenditure as recoverable costs

“(1) Transpower must calculate an opex incentive amount for each disclosure year of each regulatory period, subject to subclause (2).

“(2) Transpower shall not calculate an opex incentive amount for any disclosure year commencing prior to 1 April 2020.

“3.6.2 How to calculate opex incentive amounts

“The ‘opex incentive amount’ for a disclosure year is an amount equal to the sum of—

“(a) all amounts carried forward into that disclosure year from a disclosure year in a preceding regulatory period; and

“(b) where applicable under clause 3.6.4(1), an adjustment to the opex incentive for that disclosure year.

“3.6.3 How to calculate the amount carried forward to subsequent disclosure years

“(1) An ‘amount carried forward’ must be calculated for each disclosure year of a regulatory period, subject to subclause (5).

“(2) The ‘amount carried forward’ for the first disclosure year of a regulatory period is calculated in accordance with the formula—

\[
\text{forecast opex}_t - \text{actual opex}_t,
\]

where—

\( t \) means the disclosure year in question.
"(3) The 'amount carried forward' for a disclosure year that is not the first or last disclosure year of a regulatory period is calculated in accordance with the formula—

\[ \text{forecast opex}_t - \text{actual opex}_t - (\text{forecast opex}_{t-1} - \text{actual opex}_{t-1}) \]

where—

\( t \) means the disclosure year in question; and

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

"(4) The 'amount carried forward' for the last disclosure year of a regulatory period is nil.

"(5) Transpower shall not calculate an amount carried forward for any disclosure year commencing prior to 27 November 2014.

"(6) Each amount carried forward is notionally carried forward from the disclosure year in respect of which it is calculated into each of the subsequent 5 disclosure years.

"(7) 'Forecast opex', subject to clause 3.6.5, is, for a disclosure year, the amount of forecast operating expenditure specified by the Commission for the relevant disclosure year in an IPP determination for the purpose of calculating an opex incentive amount.

"(8) 'Actual opex' is the amount of operating costs allocated to electricity transmission services for the relevant disclosure year calculated in accordance with Part 2.

"3.6.4 How to calculate the adjustment to the opex incentive in the second year of a regulatory period

"(1) An adjustment to the opex incentive must be calculated for the second disclosure year of the regulatory period in accordance with the formula—

\[ \text{base year adjustment term + baseline adjustment term}. \]

"(2) The 'base year adjustment term' is calculated in accordance with the formula—

\[ \left( \frac{\text{forecast opex}_{t-1} - \text{actual opex}_{t-1} - (\text{forecast opex}_{t-2} - \text{actual opex}_{t-2})}{(1 + WACC)^4} \right) \]

where—

\( WACC \) means the WACC as determined by the Commission and applicable to Transpower’s current IPP;
t-1 means the disclosure year immediately prior to the current regulatory period; and

t-2 means the disclosure year commencing two years prior to the current regulatory period.

"(3) The 'baseline adjustment term' is calculated in accordance with the formula—

\[
\text{non-recurrent differences in penultimate year} \times \frac{\left(1-(1+WACC)^6\right)/WACC}{(1+WACC)^2}
\]

where—

\text{non-recurrent differences in penultimate year} means the amount calculated in accordance with subclause (4); and

WACC means the WACC as determined by the Commission and applicable to Transpower's current regulatory period.

"(4) 'non-recurrent differences in penultimate year' is an amount determined by the Commission, having regard to the views of interested persons, attributable to the impact of non-recurrent factors which cause differences between forecast opex and actual opex in the penultimate disclosure year of the preceding regulatory period, and notified to Transpower.

"SECTION 2 Price-quality path amendments and other events

"3.6.5 Calculating incentive adjustments for IPP amendments and other events

"(1) Where an IPP is amended following—

"(a) a catastrophic event;

"(b) a change event;

"(c) an error; or

"(d) provision of false or misleading information under clause 3.7.4(4),

"the forecast opex required to be used by Transpower to calculate the amount carried forward for the disclosure year in which the event occurred and each subsequent disclosure year prior to the effective date of the amendment to the IPP, is the amount specified by the Commission in the amended IPP.
“(2) Where an alteration to Part 2 or ID determination requirements affecting the quantification of operating costs allocated to electricity transmission services occurs in a disclosure year and—

“(a) the Commission considers; or

“(b) Transpower satisfies the Commission upon application,

“that the alteration has, or is likely to have, a material effect on the calculation of the opex incentive amount that would otherwise have been calculated by Transpower, then the forecast opex required to be used by Transpower to calculate the amount carried forward for that disclosure year and each subsequent disclosure year in the regulatory period may be determined by the Commission, and notified to Transpower, in order to preserve, to the extent appropriate—

“(c) the correct outcomes for expenditure efficiencies achieved before the event; and

“(d) the relevant incentive properties after the event.”.

/Sue Begg
Sue Begg, Deputy Chair

Dated at Wellington this 27th day of November 2014.

COMMERCE COMMISSION