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Draft Incremental Rolling Incentive Scheme Input Methodology Amendments 2014

Draft input methodologies made under s52X and s 52V(2) of the Commerce Act 1986 to input methodologies applicable to electricity and gas distribution businesses, gas transmission businesses, and Transpower contained in Decisions [2012] NZCC 17, [2012] NZCC 26, [2012] NZCC 27, and [2012] NZCC 28.

Date of draft determination: 18 July 2014

Incremental Rolling Incentive Scheme Input Methodology Amendments 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:

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

(b) *Gas Distribution Services Input Methodologies Determination 2012*, [2012] NZCC 27 (the **GDB IM Determination**);

(c) *Gas Transmission Services Input Methodologies Determination 2012*, [2012] NZCC 28 (the **GTB IM Determination**); and

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

2. COMMENCEMENT

This determination comes into force on the date on which notice of the determination is given in the New Zealand Gazette under section 52X of the Commerce Act 1986.

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 new definitions in clause 1.1.4:

"**incentive adjustment** means the recoverable cost amount determined under clause 3.3.1(2);

"**opex incentive adjustment** means the amount determined in accordance with clause 3.3.3(2);

"**capex incentive adjustment** means the amount determined in accordance with clause 3.3.10(1);

"**amount carried forward** means, for any given **disclosure year**, the amount determined in accordance with clause 3.3.2;

"**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 adjustment**;

"**starting price year** means a **disclosure year** for which new starting prices were determined for the **EDB** in accordance with s 53P(3), or the **disclosure year** immediately following the expiration of a **CPP**;"

4.2 In the **EDB IM Determination**, delete the definitions for "allowed controllable opex" and "actual controllable opex".

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

"any **incentive adjustment** calculated in accordance with clause 3.3.1(2);"

4.4 In the **EDB IM Determination**, replace subpart 3 of Part 3 with:

"SUBPART 3 **Incremental rolling incentive scheme**

"3.3.1 Calculation of annual incremental rolling incentive scheme recoverable costs

"(1) Subject to subclause (3), an **EDB** must calculate and apply the **incentive adjustment** as a recoverable cost for each **disclosure year** of each **regulatory period**.

"(2) The 'incentive adjustment' is the amount determined in accordance with the formula–

opex incentive adjustment + **capex incentive adjustment**.

"(3) An **EDB** must calculate the **incentive adjustment** commencing in the first full **regulatory period** commencing after the first **disclosure year** for which it has calculated an **amount carried forward**.

"(4) An **EDB** must calculate an **amount carried forward** commencing from the first **disclosure year** commencing after [date of amendment].

"**SECTION 1 Operational expenditure incentives**

"3.3.2 How to calculate the amount carried forward into subsequent disclosure years

"(1) Each **EDB** must calculate an 'amount carried forward' in each **disclosure year**, subject to clause 3.3.11.

"(2) The 'amount carried forward' in 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 –

forecast opex – actual opex

"(3) The 'amount carried forward' in all but the first or last **disclosure year** of a **regulatory period** is calculated in accordance with the formula –

$(forecast\ opex_t - actual\ opex_t) - (forecast\ opex_{t-1} - actual\ opex_{t-1})$

where–

t means the **disclosure year** for which the amount carried forward is being calculated

t-1 means the **disclosure year** prior to the **disclosure year** for which the amount carried forward is being calculated

"(4) The 'amount carried forward' in 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) 'Forecast opex' is, for a **disclosure year** –

"(a) in a **DPP regulatory period** for which new starting prices applicable to the **EDB** were determined by the **Commission** under s 53P(3)(b) or s 53X(2), the amount of **operating expenditure** determined by the **Commission** for the relevant **disclosure year** in accordance with clause 4.1.1(1);

"(b) in a **DPP regulatory period** for which the prices applicable to the **EDB** were the prices in effect at the expiration of the previous **DPP** or **CPP**, the amount of **operating expenditure** specified by the **Commission** in the **DPP determination** or, if not specified, notified by the **Commission** and calculated using the same methodology used to calculate **operating expenditure** in the most recent **regulatory period** for which new starting prices were determined under s 53P(3)(b) or in a **CPP determination**; or

"(c) in a **CPP regulatory period** applicable to the **EDB**, the amount of **forecast operating expenditure** determined by the **Commission** for the relevant **disclosure year** in accordance with clause 5.3.2(6)(b).

"(7) 'Actual opex' is the amount of **operating costs** attributable to **electricity distribution services** for the relevant **disclosure year** as reported under an **ID determination** and calculated in accordance with Part 2.

"3.3.3 How to calculate the opex incentive adjustment to be applied as a recoverable cost

"(1) Each **amount carried forward** determined in accordance with clause 3.3.2 is notionally carried forward, subject to clause 3.3.11, from the **disclosure year** in respect of which it is determined into each of the subsequent 5 **disclosure years**.

"(2) In each of the **disclosure years** after a **regulatory period** into which an **amount carried forward** has been carried pursuant to subclause (1), a net balance (the 'opex incentive adjustment') must be determined by addition of–

"(a) any **amounts carried forward** into that **disclosure year** from a preceding **regulatory period**; and

"(b) any **adjustment amounts** determined in accordance with clauses 3.3.4.

"3.3.4 How to calculate the adjustment amount in the second year of a regulatory period

"(1) The **adjustment amount** must be calculated in the second **disclosure year** of –

"(a) a **DPP regulatory period**, including a **DPP regulatory period** that has been amended by a **quality standard variation CPP determination**;

"(b) a **CPP regulatory period** (other than a **quality standard variation**) currently applicable to the **EDB**; and

"(c) following the expiration of a **CPP regulatory period** (other than a **quality standard variation**) applicable to the **EDB**, unless new starting prices have been determined for the **EDB** in accordance with s 53P(3) or a **CPP**.

"(2) The 'adjustment amount' is, subject to clause 3.3.8, in the case of an **EDB** currently subject to –

"(a) a **DPP**, subject to subclause 3.3.8(1), where the starting prices for the current **DPP regulatory period** were–

"(i) determined by the **Commission** in accordance with s 53P(3)(b) of the **Act**–

– (*base year adjustment term*)

"(ii) the prices that applied at the end of the preceding **DPP** or **CPP regulatory period**, calculated in accordance with the formula–

roll-over adjustment term – base year adjustment term

"(b) a **CPP** (other than a **quality standard variation**), subject to subclause 3.3.8(2), calculated in accordance with the formula–

CPP adjustment term 1 + CPP adjustment term 2 – base year adjustment term.

"3.3.5 How to calculate the base year adjustment term

The 'base year adjustment term' is calculated in accordance with the formula–

$$\frac{(\textit{forecast opex}_{t-1} - \textit{actual opex}_{t-1}) - (\textit{forecast opex}_{t-2} - \textit{actual opex}_{t-2})}{(1+\textit{WACC})^4}$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP** or **DPP**

t-1 means the **disclosure year** immediately preceding the current **regulatory period**

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

"3.3.6 How to calculate the roll-over adjustment term

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

$\textit{actual opex}_{t-2} - \textit{forecast opex}_{t}$

x

$((1-(1+WACC)^{-6}/WACC)$

x

$(1+WACC)^2$

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**

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

"3.3.7 How to calculate adjustment amounts applicable to CPP regulatory periods

"(1) The 'CPP adjustment term 1' is calculated in accordance with the formula –

$$\frac{\textit{conditional value} - \textbf{amount carried forward}_{t-2}}{(1+WACC)^4}$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**

t-2 means the **disclosure year** two years prior to the current **CPP regulatory period**

"(2) The 'CPP adjustment term 2' is calculated in accordance with the formula –

conditional value – **amount carried forward**$_{t-2}$

x

$((1- (1+WACC)^{-5}) / WACC)$

x

$(1+WACC)^2$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**

t-2 means the **disclosure year** two years prior to the **CPP regulatory period**

"(3) The 'conditional value' is –

"(a) if the **amount carried forward** in the **disclosure year** two years prior to the current **CPP regulatory period** was greater than zero, the greater of –

"(i) nil; or

"(ii) the **amount carried forward** in the **disclosure year** two years prior to the **CPP regulatory period** or the **amount carried forward** in the **disclosure year** two years prior to the **CPP regulatory period** plus the **amount carried forward** in the

disclosure year prior to the **CPP regulatory period**, whichever is less;

"(b) if the **amount carried forward** in the **disclosure year** two years prior to the **CPP regulatory period** was less than or equal to zero, the lesser of –

"(i) nil; or

"(ii) the **amount carried forward** in the **disclosure year** two years prior to the **CPP regulatory period** or the **amount carried forward** in the **disclosure year** two years prior to the **CPP regulatory period** plus the **amount carried forward** in the disclosure prior to the **CPP regulatory period**, whichever is greater.

"3.3.8 Additional adjustments where the preceding price-quality path applied for 1 year or less

"(1) If the **disclosure year** immediately preceding the current **DPP regulatory period** was a **starting price year**, the adjustment amount is increased by an amount calculated in accordance with the formula –

"(a) if the starting prices in the **starting price year** were new starting prices determined by the **Commission** in accordance with s 53P(3)(b) or s 53X of the Act, subject to paragraph (c) –

$$\frac{(actual\ opex_{t-3} - forecast\ opex_{t-2})}{(1+WACC)^4}$$

where–

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

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

"(b) if the starting prices in the **starting price year** were the prices that applied at the end of an immediately preceding **DPP** or **CPP regulatory period** –

starting price year adjustment term – ((the sum of all **amounts carried forward** into the **starting price year**) x $(1+WACC)^2$)

where–

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

"(2) If the **disclosure year** immediately preceding the current **CPP regulatory period** was a **starting price year**, subject to subclause (3), the adjustment amount is increased by an amount calculated in accordance with the formula –

"(a) if the starting prices in the **starting price year** were new starting prices determined by the **Commission** in accordance with s 53P(3)(b) or s 53X of the Act, subject to paragraph (c) –

starting price year adjustment term

+

$((forecast\ opex_{t-2} - actual\ opex_{t-2}) - (forecast\ opex_{t-3} - actual\ opex_{t-3})) \times (1-(1+WACC)^{-4} / WACC) \times (1+WACC)^{2}$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

"(b) if the starting prices in the **starting price year** were the prices that applied at the end of an immediately preceding **DPP** or **CPP regulatory period**, subject to paragraph (c), calculated in accordance with the formula –

starting price year adjustment term – ((the sum of all **amounts carried forward** in the **starting price year**) $\times (1+WACC)^{2}$)

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP** or **DPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

"(3) Notwithstanding subclause (2), if the two **disclosures years** immediately preceding the current regulatory period were **starting price years**, the adjustment amount is increased by an amount calculated in accordance with the formula –

"(a) if the starting prices in the **starting price year** two **disclosure years** prior to the current **CPP regulatory period** were the prices that applied at the end of an immediately preceding **CPP regulatory period**, and the starting prices in the subsequent **starting price year** were new starting prices determined by the **Commission** in accordance with s 53P(3)(b) of the Act –

$$\frac{(actual\ opex_{t-3} - forecast\ opex_{t-2})}{(1+WACC)^4}$$

–

((the sum of all **amounts carried forward** into the **starting price year**) x $(1+WACC)^3$)

+

(((*forecast* $opex_{t-2}$ – *actual* $opex_{t-2}$) – (*forecast* $opex_{t-3}$ – *actual* $opex_{t-3}$)) x $((1-(1+WACC)^{-5} / WACC) \times (1+WACC)^3)$

+

(((*forecast* $opex_{t-3}$ – *actual* $opex_{t-3}$) – (*forecast* $opex_{t-4}$ – *actual* $opex_{t-4}$)) x $((1-(1+WACC)^{-4} / WACC) \times (1+WACC)^3)$

+

(((*forecast* $opex_{t-2}$ – *actual* $opex_{t-2}$) – (*forecast* $opex_{t-3}$ – *actual* $opex_{t-3}$)) x $(1+WACC)^2$)

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

t-4 means the **disclosure year** four years prior to the current **regulatory period**

"(b) if the starting prices in each of the **starting price years** were the prices that applied at the end of an immediately preceding **regulatory period** –

$$(((\textit{forecast opex}_{t-2} - \textit{actual opex}_{t-2}) - (\textit{forecast opex}_{t-3} - \textit{actual opex}_{t-3})) \times ((1-(1+WACC)^{-5} / WACC) \times (1+WACC)^{3})$$

+

$$(((\textit{forecast opex}_{t-3} - \textit{actual opex}_{t-3}) - (\textit{forecast opex}_{t-4} - \textit{actual opex}_{t-4})) \times ((1-(1+WACC)^{-3} / WACC) \times (1+WACC)^{2})$$

+

$$(((\textit{forecast opex}_{t-2} - \textit{actual opex}_{t-2}) - (\textit{forecast opex}_{t-3} - \textit{actual opex}_{t-3})) \times (1+WACC)^{2})$$

–

((the sum of all **amounts carried forward** into the **starting price year** two **disclosure years** prior to the current **CPP regulatory period**) x $(1+WACC)^{3}$)

–

((the sum of all **amounts carried forward** into the **starting price year** immediately preceding the current **CPP regulatory period**) x $(1+WACC)^{2}$)

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

t-4 means the **disclosure year** four years prior to the current **regulatory period.**

"3.3.9 <u>How to calculate the starting price year adjustment term for DPP regulatory periods of one year</u>

The 'starting price year adjustment term' is calculated in accordance with the formula –

$$(((\textit{forecast opex}_{t-2} - \textit{actual opex}_{t-2})$$

–

(*forecast opex*$_{t-3}$ – *actual opex*$_{t-3}$))

x

$(1-(1+WACC)^{-4} / WACC) \times (1+WACC)^{2})$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP** or **DPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

"**SECTION 2 Capital expenditure incentives**

"3.3.10Capex incentive adjustment

"(1) The **capex incentive adjustment** –

"(a) must be calculated in the second **disclosure year** of each **DPP regulatory period** for which a **capex incentive adjustment** is calculated and applies, regardless of whether the **EDB** is subject to a **CPP** or the **DPP** during that **DPP regulatory period**;

"(b) in the second **disclosure year** of the **DPP regulatory period** is the amount calculated in accordance with the formula –

IRIS capex wash-up adjustment + *retention adjustment*

"(c) is nil in every other **disclosure year** of the current **DPP regulatory period**.

"(2) The 'IRIS capex wash-up adjustment' is the amount equal to the present value of the differences in the series of revenues for the preceding **DPP regulatory period**, 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**.

"(3) For the purpose of subclause (2) –

"(a) the present value must be determined by discounting the revenues to the end of the preceding **DPP regulatory period** using a discount rate equal to the **75th percentile estimate of WACC** applicable to each **disclosure year** in accordance with any **DPP determination** or **CPP determination**, and then adjusting that amount as at the commencement of the second **disclosure year** of the current **DPP regulatory period** using the **cost of debt**;

"(b) the series of revenues for each **disclosure year of** the preceding **DPP regulatory period** are those used to set starting prices for the **EDB** in any **DPP determination** or **CPP determination** and must –

"(i) be calculated using the methodology applied by the **Commission** for the **EDB** and specified in the relevant **DPP determination** or **CPP determination**;

"(ii) for subclause (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**;

"(iii) for each **disclosure year** in which the **EDB** was subject to a **DPP determination**, apply the rate of change generally applicable to all **EDB**s instead of any alternative rate of change for a particular **EDB**;

"(iv) for each **disclosure year** in which the **EDB** was subject to a **CPP determination**, apply the rate of change specified in the **CPP determination**; and

"(v) be expressed consistent with cash flow timing assumptions for calculating amounts in revenue date terms for the **EDB** and specified in the relevant **DPP determination** or **CPP determination**;

"(c) where revenues from adopting the sum of **value of commissioned assets** exceed the revenues 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 IRIS capex wash-up adjustment; and

"(d) where revenues from adopting the sum of **value of commissioned assets** is less than the revenues 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 IRIS capex wash-up adjustment.

"(8) 'Retention adjustment' is calculated in accordance with the formula –

(forecast value of commissioned assets – actual value of commissioned assets) x **retention factor**

"(9) 'Forecast value of commissioned assets' is–

"(a) for each year of the previous **DPP regulatory period** in which the supplier was subject to a **DPP**, the present value, as at the first day of the current **DPP regulatory period**, of the sum of the **forecast aggregate value of commissioned assets** for each **disclosure year**, as determined by the **Commission** and calculated in accordance with clause 4.2.5;

"(b) for each year of the previous **DPP regulatory period** in which the supplier was subject to a **CPP**, the present value, as at the first day of the current **DPP regulatory period**, of the sum of the **forecast value of commissioned assets** for each **disclosure year**, as determined by the **Commission** and calculated in accordance with clause 5.3.11.

"(10) 'Actual value of commissioned assets' is the present value, as at the first day of the current **DPP regulatory period**, of the **value of commissioned assets** for all assets that were **commissioned** during the previous **DPP regulatory period**, as disclosed under an **ID determination** and calculated in accordance with clause 2.2.11.

"(11) The 'retention factor' for each **DPP regulatory period** is the amount specified by the **Commission** in the relevant **DPP determination**.

"(12) For the **CPP regulatory period** applicable to Orion New Zealand Limited ending 31 March 2019, the methodology applied by the Commission to calculate the starting prices will be notified by the **Commission**.

"**SECTION 3 Special provisions applying after a catastrophic event**

"3.3.11 Calculating incentive adjustments after a catastrophic event

"Where a price-quality path is amended following a **catastrophic event**, the *forecast opex* and *forecast value of commissioned assets* used to calculate the **amount carried forward** in the **disclosure year** in which the **catastrophic 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**."

4.5 In the **EDB IM Determination**, insert new subpart 8 in Part 4:

"SUBPART 8 – **Incentive Mechanisms**

"4.8.1 Determination of capex incentives

"(1) The Commission will determine the **forecast return**, **forecast depreciation**, and the method for calculating return, for each **disclosure year** of the **DPP regulatory period** for all **assets** forecast to be **commissioned**.

"(2) The Commission will specify the **retention factor** that applies for each **EDB** during the **DPP regulatory period**."

4.6 In the **EDB IM Determination**, delete subclause 5.3.1(a), renumbering subsequent subclauses accordingly.

4.7 In the **EDB IM Determination**, insert new Subpart 7 in Part 5:

"5.7.1 Determination of capex incentives

"(1) The Commission will determine the **forecast return**, **forecast depreciation**, and the method for calculating return, for each **disclosure year** of the current **DPP regulatory period** for all **assets** forecast to be **commissioned**.

"(2) The Commission will specify the **retention factor** that applies for each **EDB** during the **CPP regulatory period**."

5. GDB IM AMENDMENTS

5.1 In the **GDB IM Determination**, insert the following new definitions in clause 1.1.4:

"**IRIS year** means the period of time specified in a **DPP determination** or **CPP determination** for which a **GDB**'s compliance with the price-quality path is assessed;

"**incentive adjustment** means the recoverable cost amount determined under clause 3.3.1(2);

"**opex incentive adjustment** means the amount determined in accordance with clause 3.3.3(2);

"**capex incentive adjustment** means the amount determined in accordance with clause 3.3.10(1);

"**amount carried forward** means, for any given **IRIS year**, the amount determined in accordance with clause 3.3.2;

"**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 adjustment**;

"**starting price year** means an **IRIS year** for which new starting prices were determined for the **GDB** in accordance with s 53P(3), or the **IRIS year** immediately following the expiration of a **CPP**;"

5.2 In the **GDB IM Determination**, delete the definitions for "allowed controllable opex" and "actual controllable opex".

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

"any **incentive adjustment** calculated in accordance with clause 3.3.1(2);"

5.4 In the **GDB IM Determination**, replace subpart 3 of Part 3 with:

"SUBPART 3 **Incremental rolling incentive scheme**

"3.3.1 Calculation of annual incremental rolling incentive scheme recoverable costs

"(1) Subject to subclause (3), an **GDB** must calculate and apply the **incentive adjustment** as a recoverable cost for each **IRIS year** of each **regulatory period**.

"(2) The 'incentive adjustment' is the amount determined in accordance with the formula–

opex incentive adjustment + **capex incentive adjustment**.

"(3) An **GDB** must calculate the **incentive adjustment** commencing in the first full **regulatory period** commencing after the first **IRIS year** for which it has calculated an **amount carried forward**.

"(4) An **GDB** must calculate an **amount carried forward** commencing from the first **IRIS year** commencing after [date of amendment].

"**SECTION 1 Operational expenditure incentives**

"3.3.2 How to calculate the amount carried forward into subsequent IRIS years

"(1) Each **GDB** must calculate an 'amount carried forward' in each **IRIS year**, subject to clause 3.3.11.

"(2) The 'amount carried forward' in the first **IRIS year** of a **regulatory period**, including the first **IRIS year** following expiration of a **CPP determination** applicable to the **GDB**, subject to subclause (5), is calculated in accordance with the formula –

forecast opex – actual opex

"(3) The 'amount carried forward' in all but the first or last **IRIS year** of a **regulatory period** is calculated in accordance with the formula –

$(forecast\ opex_t - actual\ opex_t) - (forecast\ opex_{t-1} - actual\ opex_{t-1})$

where–

t means the **IRIS year** for which the amount carried forward is being calculated

t-1 means the **IRIS year** prior to the **IRIS year** for which the amount carried forward is being calculated

"(4) The 'amount carried forward' in the last **IRIS year** of a **regulatory period** is nil.

"(5) Where an **GDB** is subject to a **DPP determination** for no more than one consecutive **IRIS year** of the **DPP regulatory period**, the 'amount carried forward' for that **IRIS year** is nil.

"(6) 'Forecast opex' is, for an **IRIS year** –

"(a) in a **DPP regulatory period** for which new starting prices applicable to the **GDB** were determined by the **Commission** under s 53P(3)(b) or s 53X(2), the amount of **operating expenditure** determined by the **Commission** for the relevant **IRIS year** in accordance with clause 4.1.1(1);

"(b) in a **DPP regulatory period** for which the prices applicable to the **GDB** were the prices in effect at the expiration of the previous **DPP** or **CPP**,

the amount of **operating expenditure** specified by the **Commission** in the **DPP determination** or, if not specified, notified by the **Commission** and calculated using the same methodology used to calculate **operating expenditure** in the most recent **regulatory period** for which new starting prices were determined under s 53P(3)(b) or in a **CPP determination**; or

"(c) in a **CPP regulatory period** applicable to the **GDB**, the amount of **forecast operating expenditure** determined by the **Commission** for the relevant **IRIS year** in accordance with clause 5.3.2(6)(b).

"(7) 'Actual opex' is the amount of **operating costs** attributable to **gas distribution services** for the relevant **IRIS year** calculated in accordance with Part 2 and reported under an **ID determination**, with the amounts reported in each **disclosure year** pro-rated by the number of months in the **disclosure year** that relates to the **IRIS year**.

"3.3.3 How to calculate the opex incentive adjustment to be applied as a recoverable cost

"(1) Each **amount carried forward** determined in accordance with clause 3.3.2 is notionally carried forward, subject to clause 3.3.11, from the **IRIS year** in respect of which it is determined into each of the subsequent 5 **IRIS years**.

"(2) In each of the **IRIS years** after a **regulatory period** into which an **amount carried forward** has been carried pursuant to subclause (1), a net balance (the 'opex incentive adjustment') must be determined by addition of–

(a) any **amounts carried forward** into that **IRIS year** from a preceding **regulatory period**; and

(b) any **adjustment amounts** determined in accordance with clauses 3.3.4.

"3.3.4 How to calculate the adjustment amount in the second year of a regulatory period

"(1) The **adjustment amount** must be calculated in the second **IRIS year** of –

"(a) a **DPP regulatory period**, including a **DPP regulatory period** that has been amended by a **quality standard variation CPP determination**;

"(b) a **CPP regulatory period** (other than a **quality standard variation**) currently applicable to the **GDB**; and

"(c) following the expiration of a **CPP regulatory period** (other than a **quality standard variation**) applicable to the **GDB**, unless new starting prices have been determined for the **GDB** in accordance with s 53P(3) or a **CPP**.

"(2) The 'adjustment amount' is, subject to clause 3.3.8, in the case of an **GDB** currently subject to –

"(a) a **DPP**, subject to subclause 3.3.8(1), where the starting prices for the current **DPP regulatory period** were–

"(i) determined by the **Commission** in accordance with s 53P(3)(b) of the **Act**–

– (*base year adjustment term*)

"(ii) the prices that applied at the end of the preceding **DPP** or **CPP regulatory period**, calculated in accordance with the formula–

roll-over adjustment term – base year adjustment term

"(b) a **CPP** (other than a **quality standard variation**), subject to subclause 3.3.8(2), calculated in accordance with the formula–

CPP adjustment term 1 + *CPP adjustment term 2 – base year adjustment term*.

"3.3.5 <u>How to calculate the base year adjustment term</u>

The 'base year adjustment term' is calculated in accordance with the formula–

$$\frac{(\textit{forecast opex}_{t-1} - \textit{actual opex}_{t-1}) - (\textit{forecast opex}_{t-2} - \textit{actual opex}_{t-2})}{(1+\textit{WACC})^4}$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GDB**'s current **CPP** or **DPP**

t-1 means the **IRIS year** immediately preceding the current **regulatory period**

t-2 means the **IRIS year** two years prior to the current **regulatory period**

"3.3.6 <u>How to calculate the roll-over adjustment term</u>

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

$\textit{actual opex}_{t-2} - \textit{forecast opex}_{t}$

x

$((1-(1+WACC)^{-6}/WACC)$

x

$(1+WACC)^2$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GDB**'s current **DPP**

t means the first **IRIS year** of the current **regulatory period**

t-2 means the **IRIS year** two years prior to the current **regulatory period**

"3.3.7 How to calculate adjustment amounts applicable to CPP regulatory periods

"(1) The 'CPP adjustment term 1' is calculated in accordance with the formula –

$$\frac{\textit{conditional value} - \textbf{amount carried forward}_{t-2}}{(1+WACC)^4}$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GDB**'s current **CPP**

t-2 means the **IRIS year** two years prior to the current **CPP regulatory period**

"(2) The 'CPP adjustment term 2' is calculated in accordance with the formula –

conditional value – **amount carried forward**$_{t-2}$

x

$((1- (1+WACC)^{-5}) / WACC)$

x

$(1+WACC)^2$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GDB**'s current **CPP**

t-2 means the **IRIS year** two years prior to the **CPP regulatory period**

"(3) The 'conditional value' is –

"(a) if the **amount carried forward** in the **IRIS year** two years prior to the current **CPP regulatory period** was greater than zero, the greater of –

"(i) nil; or

"(ii) the **amount carried forward** in the **IRIS year** two years prior to the **CPP regulatory period** or the **amount carried forward** in the **IRIS year** two years prior to the **CPP regulatory period** plus the **amount carried forward** in the **IRIS year** prior to the **CPP regulatory period**, whichever is less;

"(b) if the **amount carried forward** in the **IRIS year** two years prior to the **CPP regulatory period** was less than or equal to zero, the lesser of –

"(i) nil; or

"(ii) the **amount carried forward** in the **IRIS year** two years prior to the **CPP regulatory period** or the **amount carried forward** in the **IRIS year** two years prior to the **CPP regulatory period** plus the **amount carried forward** in the disclosure prior to the **CPP regulatory period**, whichever is greater.

"3.3.8 Additional adjustments where the preceding price-quality path applied for 1 year or less

"(1) If the **IRIS year** immediately preceding the current **DPP regulatory period** was a **starting price year**, the adjustment amount is increased by an amount calculated in accordance with the formula –

"(a) if the starting prices in the **starting price year** were new starting prices determined by the **Commission** in accordance with s 53P(3)(b) or s 53X of the Act, subject to paragraph (c) –

$$\frac{(actual\ opex_{t-3} - forecast\ opex_{t-2})}{(1+WACC)^4}$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GDB**'s current **DPP**

t-2 means the **IRIS year** two years prior to the current **regulatory period**

t-3 means the **IRIS year** three years prior to the current **regulatory period**.

"(b) if the starting prices in the **starting price year** were the prices that applied at the end of an immediately preceding **DPP** or **CPP regulatory period** –

starting price year adjustment term – ((the sum of all **amounts carried forward** into the **starting price year**) x $(1+WACC)^2$)

where –

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **DPP**

"(2) If the **IRIS year** immediately preceding the current **CPP regulatory period** was a **starting price year**, subject to subclause (3), the adjustment amount is increased by an amount calculated in accordance with the formula –

"(a) if the starting prices in the **starting price year** were new starting prices determined by the **Commission** in accordance with s 53P(3)(b) or s 53X of the Act, subject to paragraph (c) –

starting price year adjustment term

+

$((forecast\ opex_{t-2} - actual\ opex_{t-2}) - (forecast\ opex_{t-3} - actual\ opex_{t-3})) \times (1-(1+WACC)^{-4} / WACC) \times (1+WACC)^2$)

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GDB**'s current **DPP**

t-2 means the **IRIS year** two years prior to the current **regulatory period**

t-3 means the **IRIS year** three years prior to the current **regulatory period**

"(b) if the starting prices in the **starting price year** were the prices that applied at the end of an immediately preceding **DPP** or **CPP regulatory period**, subject to paragraph (c), calculated in accordance with the formula –

starting price year adjustment term – ((the sum of all **amounts carried forward** in the **starting price year**) x $(1+WACC)^2$)

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GDB**'s current **DPP**

t-2 means the **IRIS year** two years prior to the current **regulatory period**

t-3 means the **IRIS year** three years prior to the current **regulatory period.**

"(3) Notwithstanding subclause (2), if the two **disclosures years** immediately preceding the current regulatory period were **starting price years**, the adjustment amount is increased by an amount calculated in accordance with the formula –

"(a) if the starting prices in the **starting price year** two **IRIS years** prior to the current **CPP regulatory period** were the prices that applied at the end of an immediately preceding **CPP regulatory period**, and the starting prices in the subsequent **starting price year** were new starting prices determined by the **Commission** in accordance with s 53P(3)(b) of the Act –

$$\frac{(actual\ opex_{t-3} - forecast\ opex_{t-2})}{(1+WACC)^4}$$

–

((the sum of all **amounts carried forward** into the **starting price year**) x $(1+WACC)^3$)

+

(((*forecast* $opex_{t-2}$ – *actual* $opex_{t-2}$) – (*forecast* $opex_{t-3}$ – *actual* $opex_{t-3}$)) x $((1-(1+WACC)^{-5} / WACC) \times (1+WACC)^3)$

+

(((*forecast* $opex_{t-3}$ – *actual* $opex_{t-3}$) – (*forecast* $opex_{t-4}$ – *actual* $opex_{t-4}$)) x $((1-(1+WACC)^{-4} / WACC) \times (1+WACC)^3)$

+

(((*forecast* $opex_{t-2}$ – *actual* $opex_{t-2}$) – (*forecast* $opex_{t-3}$ – *actual* $opex_{t-3}$)) x $(1+WACC)^2$)

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GDB**'s current **CPP**

t-2 means the **IRIS year** two years prior to the current **regulatory period**

t-3 means the **IRIS year** three years prior to the current **regulatory period**

t-4 means the **IRIS year** four years prior to the current **regulatory period**

"(b) if the starting prices in each of the **starting price years** were the prices that applied at the end of an immediately preceding **regulatory period** –

$$(((\textit{forecast opex}_{t-2} - \textit{actual opex}_{t-2}) - (\textit{forecast opex}_{t-3} - \textit{actual opex}_{t-3})) \times ((1-(1+WACC)^{-5} / WACC) \times (1+WACC)^{3})$$

+

$$(((\textit{forecast opex}_{t-3} - \textit{actual opex}_{t-3}) - (\textit{forecast opex}_{t-4} - \textit{actual opex}_{t-4})) \times ((1-(1+WACC)^{-3} / WACC) \times (1+WACC)^{2})$$

+

$$(((\textit{forecast opex}_{t-2} - \textit{actual opex}_{t-2}) - (\textit{forecast opex}_{t-3} - \textit{actual opex}_{t-3})) \times (1+WACC)^{2})$$

–

((the sum of all **amounts carried forward** into the **starting price year** two **disclosure years** prior to the current **CPP regulatory period**) x $(1+WACC)^{3}$)

–

((the sum of all **amounts carried forward** into the **starting price year** immediately preceding the current **CPP regulatory period**) x $(1+WACC)^{2}$)

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GDB**'s current **CPP**

t-2 means the **IRIS year** two years prior to the current **regulatory period**

t-3 means the **IRIS year** three years prior to the current **regulatory period**

t-4 means the **IRIS year** four years prior to the current **regulatory period.**

"3.3.9 How to calculate the starting price year adjustment term for DPP regulatory periods of one year

The 'starting price year adjustment term' is calculated in accordance with the formula –

$$(((forecast\ opex_{t-2} - actual\ opex_{t-2}) - (forecast\ opex_{t-3} - actual\ opex_{t-3})) \times (1-(1+WACC)^{-4} / WACC) \times (1+WACC)^{2})$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GDB**'s current **CPP** or **DPP**

t-2 means the **IRIS year** two years prior to the current **regulatory period**

t-3 means the **IRIS year** three years prior to the current **regulatory period**

"**SECTION 2 Capital expenditure incentives**

"3.3.10 Capex incentive adjustment

"(1) The **capex incentive adjustment** –

"(a) must be calculated in the second **IRIS year** of each **DPP regulatory period** for which a **capex incentive adjustment** is calculated and applies, regardless of whether the **GDB** is subject to a **CPP** or the **DPP** during that **DPP regulatory period**;

"(b) in the second **IRIS year** of the **DPP regulatory period** is the amount calculated in accordance with the formula –

IRIS capex wash-up adjustment+ retention adjustment

"(c) is nil in every other **IRIS year** of the current **DPP regulatory period**.

"(2) The 'IRIS capex wash-up adjustment' is the amount equal to the present value of the differences in the series of revenues for the preceding **DPP regulatory period**, adopting-

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

"instead of–

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

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

"(3) For the purpose of subclause (2) –

"(a) the present value must be determined by discounting the revenues to the end of the preceding **DPP regulatory period** using a discount rate equal to the **75th percentile estimate of WACC** applicable to each **IRIS year** in accordance with any **DPP determination** or **CPP determination**, and then adjusting that amount as at the commencement of the second **IRIS year** of the current **DPP regulatory period** using the **cost of debt**;

"(b) the series of revenues for each **IRIS year of** the preceding **DPP regulatory period** are those used to set starting prices for the **GDB** in any **DPP determination** or **CPP determination** and must –

"(i) be calculated using the methodology applied by the **Commission** for the **GDB** and specified in the relevant **DPP determination** or **CPP determination**;

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

"(iii) for each **IRIS year** in which the **GDB** was subject to a **DPP determination**, apply the rate of change generally applicable to all **GDB**s instead of any alternative rate of change for a particular **GDB**;

"(iv) for each **IRIS year** in which the **GDB** was subject to a **CPP determination**, apply the rate of change specified in the **CPP determination**; and

"(v) be expressed consistent with cash flow timing assumptions for calculating amounts in revenue date terms for the **GDB** and specified in the relevant **DPP determination** or **CPP determination**;

"(c) where revenues from adopting the sum of **value of commissioned assets** exceed the revenues from using the forecast values of commissioned assets (as determined using the **forecast aggregate value of commissioned assets** for each **IRIS year** in which the **GDB** was subject to a **DPP** and sum of the **forecast value of commissioned assets** for each **IRIS year** in which the **GDB** was subject to a **CPP**) then the difference is a positive amount of IRIS capex wash-up adjustment; and

"(d) where revenues from adopting the sum of **value of commissioned assets** is less than the revenues from using the forecast value of commissioned assets (as determined using the **forecast aggregate value of commissioned assets** for each **IRIS year** in which the **GDB** was subject to a **DPP** and sum of the **forecast value of commissioned assets** for each **IRIS year** in which the **GDB** was subject to a **CPP**) then the difference is a negative amount of IRIS capex wash-up adjustment.

"(8) 'Retention adjustment' is calculated in accordance with the formula –

(forecast value of commissioned assets – actual value of commissioned assets) x **retention factor**

"(9) 'Forecast value of commissioned assets' is–

"(a) for each year of the previous **DPP regulatory period** in which the supplier was subject to a **DPP**, the present value, as at the first day of the current **DPP regulatory period**, of the sum of the **forecast aggregate value of commissioned assets** for each **IRIS year**, as determined by the **Commission** and calculated in accordance with clause 4.2.5;

"(b) for each year of the previous **DPP regulatory period** in which the supplier was subject to a **CPP**, the present value, as at the first day of the current **DPP regulatory period**, of the sum of the **forecast value of commissioned assets** for each **IRIS year**, as determined by the **Commission** and calculated in accordance with clause 5.3.11.

"(10) 'Actual value of commissioned assets' is the present value, as at the first day of the current **DPP regulatory period**, of the **value of commissioned assets** for all assets that were **commissioned** during the previous **DPP regulatory period**, calculated in accordance with clause 2.2.11 and consistent with the amounts reported under an **ID determination**.

"(11) The 'retention factor' for each **DPP regulatory period** is the amount specified by the **Commission** in the relevant **DPP determination**.

"(12) For the **DPP regulatory period** ending 30 September 2017, the methodology applied by the Commission to calculate the starting prices will be notified by the **Commission**.

"**SECTION 3 Special provisions applying after a catastrophic event**

"3.3.11 Calculating incentive adjustments after a catastrophic event

"Where a price-quality path is amended following a **catastrophic event**, the *forecast opex* and *forecast value of commissioned assets* used to calculate the **amount carried forward** in the **IRIS year** in which the **catastrophic event** occurred and each subsequent **IRIS 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**."

5.5 In the **GDB IM Determination**, insert new subpart 8 in Part 4:

"SUBPART 8 – **Incentive Mechanisms**

"4.8.1 Determination of capex incentives

"(1) The Commission will determine the **forecast return**, **forecast depreciation**, and the method for calculating return, for each IRIS year of the **DPP regulatory period** for all **assets** forecast to be **commissioned**.

"(2) The Commission will specify the **retention factor** that applies for each **GDB** during the **DPP regulatory period**."

5.6 In the **GDB IM Determination**, delete subclause 5.3.1(a), renumbering subsequent subclauses accordingly.

5.7 In the **GDB IM Determination**, insert new Subpart 7 in Part 5:

"5.7.1 Determination of capex incentives

"(1) The Commission will determine the **forecast return**, **forecast depreciation**, and the method for calculating return, for each IRIS year of the current **DPP regulatory period** for all **assets** forecast to be **commissioned**.

"(2) The Commission will specify the **retention factor** that applies for each **GDB** during the **CPP regulatory period**."

6. GTB IM AMENDMENTS

6.1 In the **GTB IM Determination**, insert the following new definitions in clause 1.1.4:

"**incentive adjustment** means the recoverable cost amount determined under clause 3.3.1(2);

"**opex incentive adjustment** means the amount determined in accordance with clause 3.3.3(2);

"**capex incentive adjustment** means the amount determined in accordance with clause 3.3.10(1);

"**amount carried forward** means, for any given **disclosure year**, the amount determined in accordance with clause 3.3.2;

"**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 adjustment**;

"**starting price year** means a **disclosure year** for which new starting prices were determined for the **GTB** in accordance with s 53P(3), or the **disclosure year** immediately following the expiration of a **CPP**;"

6.2 In the **GTB IM Determination**, delete the definitions for "allowed controllable opex" and "actual controllable opex".

6.3 In the **GTB IM Determination**, replace clause 3.1.3(1)(a) with:

"any **incentive adjustment** calculated in accordance with clause 3.3.1(2);"

6.4 In the **GTB IM Determination**, replace subpart 3 of Part 3 with:

"SUBPART 3 **Incremental rolling incentive scheme**

"3.3.1 Calculation of annual incremental rolling incentive scheme recoverable costs

"(1) Subject to subclause (3), an **GTB** must calculate and apply the **incentive adjustment** as a recoverable cost for each **disclosure year** of each **regulatory period**.

"(2) The 'incentive adjustment' is the amount determined in accordance with the formula–

opex incentive adjustment + **capex incentive adjustment**.

"(3) An **GTB** must calculate the **incentive adjustment** commencing in the first full **regulatory period** commencing after the first **disclosure year** for which it has calculated an **amount carried forward**.

"(4) An **GTB** must calculate an **amount carried forward** commencing from the first **disclosure year** commencing after [date of amendment].

"**SECTION 1 Operational expenditure incentives**

"3.3.2 How to calculate the amount carried forward into subsequent disclosure years

"(1) Each **GTB** must calculate an 'amount carried forward' in each **disclosure year**, subject to clause 3.3.11.

"(2) The 'amount carried forward' in the first **disclosure year** of a **regulatory period**, including the first **disclosure year** following expiration of a **CPP determination** applicable to the **GTB**, subject to subclause (5), is calculated in accordance with the formula –

forecast opex – actual opex

"(3) The 'amount carried forward' in all but the first or last **disclosure year** of a **regulatory period** is calculated in accordance with the formula –

$(forecast\ opex_t - actual\ opex_t) - (forecast\ opex_{t-1} - actual\ opex_{t-1})$

where–

t means the **disclosure year** for which the amount carried forward is being calculated

t-1 means the **disclosure year** prior to the **disclosure year** for which the amount carried forward is being calculated

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

"(5) Where an **GTB** 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) 'Forecast opex' is, for a **disclosure year** –

"(a) in a **DPP regulatory period** for which new starting prices applicable to the **GTB** were determined by the **Commission** under s 53P(3)(b) or s 53X(2), the amount of **operating expenditure** determined by the **Commission** for the relevant **disclosure year** in accordance with clause 4.1.1(1);

"(b) in a **DPP regulatory period** for which the prices applicable to the **GTB** were the prices in effect at the expiration of the previous **DPP** or **CPP**, the amount of **operating expenditure** specified by the **Commission** in the **DPP determination** or, if not specified, notified by the

Commission and calculated using the same methodology used to calculate **operating expenditure** in the most recent **regulatory period** for which new starting prices were determined under s 53P(3)(b) or in a **CPP determination**; or

"(c) in a **CPP regulatory period** applicable to the **GTB**, the amount of **forecast operating expenditure** determined by the **Commission** for the relevant **disclosure year** in accordance with clause 5.3.2(6)(b).

"(7) 'Actual opex' is the amount of **operating costs** attributable to **electricity transmission services** for the relevant **disclosure year** as reported under an **ID determination** and calculated in accordance with Part 2.

"3.3.3 How to calculate the opex incentive adjustment to be applied as a recoverable cost

"(1) Each **amount carried forward** determined in accordance with clause 3.3.2 is notionally carried forward, subject to clause 3.3.11, from the **disclosure year** in respect of which it is determined into each of the subsequent 5 **disclosure years**.

"(2) In each of the **disclosure years** after a **regulatory period** into which an **amount carried forward** has been carried pursuant to subclause (1), a net balance (the 'opex incentive adjustment') must be determined by addition of–

"(a) any **amounts carried forward** into that **disclosure year** from a preceding **regulatory period**; and

"(b) any **adjustment amounts** determined in accordance with clauses 3.3.4.

"3.3.4 How to calculate the adjustment amount in the second year of a regulatory period

"(1) The **adjustment amount** must be calculated in the second **disclosure year** of –

"(a) a **DPP regulatory period**, including a **DPP regulatory period** that has been amended by a **quality standard variation CPP determination**;

"(b) a **CPP regulatory period** (other than a **quality standard variation**) currently applicable to the **GTB**; and

"(c) following the expiration of a **CPP regulatory period** (other than a **quality standard variation**) applicable to the **GTB**, unless new starting prices have been determined for the **GTB** in accordance with s 53P(3) or a **CPP**.

"(2) The 'adjustment amount' is, subject to clause 3.3.8, in the case of an **GTB** currently subject to –

"(a) a **DPP**, subject to subclause 3.3.8(1), where the starting prices for the current **DPP regulatory period** were–

"(i) determined by the **Commission** in accordance with s 53P(3)(b) of the **Act**–

– (*base year adjustment term*)

"(ii) the prices that applied at the end of the preceding **DPP** or **CPP regulatory period**, calculated in accordance with the formula–

roll-over adjustment term – base year adjustment term

"(b) a **CPP** (other than a **quality standard variation**), subject to subclause 3.3.8(2), calculated in accordance with the formula–

CPP adjustment term 1 + *CPP adjustment term 2 – base year adjustment term*.

"3.3.5 <u>How to calculate the base year adjustment term</u>

The 'base year adjustment term' is calculated in accordance with the formula–

$$\frac{(forecast\ opex_{t-1} - actual\ opex_{t-1}) - (forecast\ opex_{t-2} - actual\ opex_{t-2})}{(1+WACC)^4}$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **CPP** or **DPP**

t-1 means the **disclosure year** immediately preceding the current **regulatory period**

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

"3.3.6 <u>How to calculate the roll-over adjustment term</u>

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

$actual\ opex_{t-2} - forecast\ opex_{t}$

x

$((1-(1+WACC)^{-6}/WACC)$

x

$(1+WACC)^2$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **DPP**

t means the first **disclosure year** of the current **regulatory period**

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

"3.3.7 How to calculate adjustment amounts applicable to CPP regulatory periods

"(1) The 'CPP adjustment term 1' is calculated in accordance with the formula –

$$\frac{\textit{conditional value} - \textbf{amount carried forward}_{t-2}}{(1+WACC)^4}$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **CPP**

t-2 means the **disclosure year** two years prior to the current **CPP regulatory period**

"(2) The 'CPP adjustment term 2' is calculated in accordance with the formula –

conditional value – **amount carried forward**$_{t-2}$

x

$((1- (1+WACC)^{-5}) / WACC)$

x

$(1+WACC)^2$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **CPP**

t-2 means the **disclosure year** two years prior to the **CPP regulatory period**

"(3) The 'conditional value' is –

"(a) if the **amount carried forward** in the **disclosure year** two years prior to the current **CPP regulatory period** was greater than zero, the greater of –

"(i) nil; or

"(ii) the **amount carried forward** in the **disclosure year** two years prior to the **CPP regulatory period** or the **amount carried forward** in the **disclosure year** two years prior to the **CPP regulatory period** plus the **amount carried forward** in the **disclosure year** prior to the **CPP regulatory period**, whichever is less;

"(b) if the **amount carried forward** in the **disclosure year** two years prior to the **CPP regulatory period** was less than or equal to zero, the lesser of –

"(i) nil; or

"(ii) the **amount carried forward** in the **disclosure year** two years prior to the **CPP regulatory period** or the **amount carried forward** in the **disclosure year** two years prior to the **CPP regulatory period** plus the **amount carried forward** in the disclosure prior to the **CPP regulatory period**, whichever is greater.

"3.3.8 Additional adjustments where the preceding price-quality path applied for 1 year or less

"(1) If the **disclosure year** immediately preceding the current **DPP regulatory period** was a **starting price year**, the adjustment amount is increased by an amount calculated in accordance with the formula –

"(a) if the starting prices in the **starting price year** were new starting prices determined by the **Commission** in accordance with s 53P(3)(b) or s 53X of the Act, subject to paragraph (c)–

$$\frac{(actual\ opex_{t-3} - forecast\ opex_{t-2})}{(1+WACC)^4}$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **DPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

"(b) if the starting prices in the **starting price year** were the prices that applied at the end of an immediately preceding **DPP** or **CPP regulatory period** –

starting price year adjustment term – ((the sum of all **amounts carried forward** into the **starting price year**) x $(1+WACC)^2$)

where –

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **DPP**

"(2) If the **disclosure year** immediately preceding the current **CPP regulatory period** was a **starting price year**, subject to subclause (3), the adjustment amount is increased by an amount calculated in accordance with the formula –

"(a) if the starting prices in the **starting price year** were new starting prices determined by the **Commission** in accordance with s 53P(3)(b) or s 53X of the Act, subject to paragraph (c) –

starting price year adjustment term

+

$((forecast\ opex_{t-2} - actual\ opex_{t-2}) - (forecast\ opex_{t-3} - actual\ opex_{t-3})) \times (1-(1+WACC)^{-4} / WACC) \times (1+WACC)^2$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **CPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

"(b) if the starting prices in the **starting price year** were the prices that applied at the end of an immediately preceding **DPP** or **CPP regulatory period**, subject to paragraph (c), calculated in accordance with the formula –

starting price year adjustment term – ((the sum of all **amounts carried forward** in the **starting price year**) x $(1+WACC)^2$)

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **CPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

"(3) if the two **disclosures years** immediately preceding the current regulatory period were **starting price years**, calculated in accordance with the formula –

"(a) if the starting prices in the **starting price year** two **disclosure years** prior to the current **CPP regulatory period** were the prices that applied at the end of an immediately preceding **CPP regulatory period**, and the starting prices in the subsequent **starting price year** were new starting prices determined by the **Commission** in accordance with s 53P(3)(b) of the Act –

$$\frac{(actual\ opex_{t-3} - forecast\ opex_{t-2})}{(1+WACC)^4}$$

–

((the sum of all **amounts carried forward** into the **starting price year**) x $(1+WACC)^3$)

+

(((*forecast* $opex_{t-2}$ – *actual* $opex_{t-2}$) – (*forecast* $opex_{t-3}$ – *actual* $opex_{t-3}$)) x $((1-(1+WACC)^{-5} / WACC) \times (1+WACC)^3)$

+

(((*forecast* $opex_{t-3}$ – *actual* $opex_{t-3}$) – (*forecast* $opex_{t-4}$ – *actual* $opex_{t-4}$)) x $((1-(1+WACC)^{-4} / WACC) \times (1+WACC)^3)$

+

(((*forecast* $opex_{t-2}$ – *actual* $opex_{t-2}$) – (*forecast* $opex_{t-3}$ – *actual* $opex_{t-3}$)) x $(1+WACC)^2$)

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **CPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

t-4 means the **disclosure year** four years prior to the current **regulatory period**

"(b) if the starting prices in each of the **starting price years** were the prices that applied at the end of an immediately preceding **regulatory period** –

$$((forecast\ opex_{t-2} - actual\ opex_{t-2}) - (forecast\ opex_{t-3} - actual\ opex_{t-3})) \times ((1-(1+WACC)^{-5} / WACC) \times (1+WACC)^{3})$$

+

$$((forecast\ opex_{t-3} - actual\ opex_{t-3}) - (forecast\ opex_{t-4} - actual\ opex_{t-4})) \times ((1-(1+WACC)^{-3} / WACC) \times (1+WACC)^{2})$$

+

$$((forecast\ opex_{t-2} - actual\ opex_{t-2}) - (forecast\ opex_{t-3} - actual\ opex_{t-3})) \times (1+WACC)^{2})$$

–

((the sum of all **amounts carried forward** into the **starting price year** two **disclosure years** prior to the current **CPP regulatory period**) x $(1+WACC)^{3}$)

–

((the sum of all **amounts carried forward** into the **starting price year** immediately preceding the current **CPP regulatory period**) x $(1+WACC)^{2}$)

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **CPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

t-4 means the **disclosure year** four years prior to the current **regulatory period.**

"3.3.9 How to calculate the starting price year adjustment term for DPP regulatory periods of one year

The 'starting price year adjustment term' is calculated in accordance with the formula –

$$(((forecast\ opex_{t-2} - actual\ opex_{t-2}) - (forecast\ opex_{t-3} - actual\ opex_{t-3})) \times (1-(1+WACC)^{-4} / WACC) \times (1+WACC)^{2})$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **GTB**'s current **CPP** or **DPP**

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

t-3 means the **disclosure year** three years prior to the current **regulatory period**

"**SECTION 2 Capital expenditure incentives**

"3.3.10 Capex incentive adjustment

"(1) The **capex incentive adjustment** –

"(a) must be calculated in the second **disclosure year** of each **DPP regulatory period** for which a **capex incentive adjustment** is calculated and applies, regardless of whether the **GTB** is subject to a **CPP** or the **DPP** during that **DPP regulatory period**;

"(b) in the second **disclosure year** of the **DPP regulatory period** is the amount calculated in accordance with the formula –

IRIS capex wash-up adjustment + *retention adjustment*

"(c) is nil in every other **disclosure year** of the current **DPP regulatory period**.

"(2) The 'IRIS capex wash-up adjustment' is the amount equal to the present value of the differences in the series of revenues for the preceding **DPP regulatory period**, 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 **GTB** 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 **GTB** was subject to a **CPP**, the sum of the **forecast value of commissioned assets** determined by the **Commission** in respect of those **disclosure years**.

"(3) For the purpose of subclause (2) –

"(a) the present value must be determined by discounting the revenues to the end of the preceding **DPP regulatory period** using a discount rate equal to the **75th percentile estimate of WACC** applicable to each **disclosure year** in accordance with any **DPP determination** or **CPP determination**, and then adjusting that amount as at the commencement of the second **disclosure year** of the current **DPP regulatory period** using the **cost of debt**;

"(b) the series of revenues for each **disclosure year of** the preceding **DPP regulatory period** are those used to set starting prices for the **GTB** in any **DPP determination** or **CPP determination** and must –

"(i) be calculated using the methodology applied by the **Commission** for the **GTB** and specified in the relevant **DPP determination** or **CPP determination**;

"(ii) for subclause (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**;

"(iii) for each **disclosure year** in which the **GTB** was subject to a **DPP determination**, apply the rate of change generally applicable to all **GTB**s instead of any alternative rate of change for a particular **GTB**;

"(iv) for each **disclosure year** in which the **GTB** was subject to a **CPP determination**, apply the rate of change specified in the **CPP determination**; and

"(v) be expressed consistent with cash flow timing assumptions for calculating amounts in revenue date terms for the **GTB** and specified in the relevant **DPP determination** or **CPP determination**;

"(c) where revenues from adopting the sum of **value of commissioned assets** exceed the revenues 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 **GTB** was subject to a **DPP** and sum of the **forecast value of commissioned assets** for each **disclosure year** in which the **GTB** was subject to a **CPP**) then the difference is a positive amount of IRIS capex wash-up adjustment; and

"(d) where revenues from adopting the sum of **value of commissioned assets** is less than the revenues 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 **GTB** was subject to a **DPP** and sum of the **forecast value of commissioned assets** for each **disclosure year** in which the **GTB** was subject to a **CPP**) then the difference is a negative amount of IRIS capex wash-up adjustment.

"(8) 'Retention adjustment' is calculated in accordance with the formula –

(forecast value of commissioned assets – actual value of commissioned assets) x **retention factor**

"(9) 'Forecast value of commissioned assets' is–

"(a) for each year of the previous **DPP regulatory period** in which the supplier was subject to a **DPP**, the present value, as at the first day of the current **DPP regulatory period**, of the sum of the **forecast aggregate value of commissioned assets** for each **disclosure year**, as determined by the **Commission** and calculated in accordance with clause 4.2.5;

"(b) for each year of the previous **DPP regulatory period** in which the supplier was subject to a **CPP**, the present value, as at the first day of the current **DPP regulatory period**, of the sum of the **forecast value of commissioned assets** for each **disclosure year**, as determined by the **Commission** and calculated in accordance with clause 5.3.11.

"(10) 'Actual value of commissioned assets' is the present value, as at the first day of the current **DPP regulatory period**, of the **value of commissioned assets**

for all assets that were **commissioned** during the previous **DPP regulatory period**, as disclosed under an **ID determination** and calculated in accordance with clause 2.2.11.

"(11) The 'retention factor' for each **DPP regulatory period** is the amount specified by the **Commission** in the relevant **DPP determination**.

"(12) For the **DPP regulatory period** ending 30 September 2017, the methodology applied by the Commission to calculate the starting prices will be notified by the **Commission**.

"**SECTION 3 Special provisions applying after a catastrophic event**

"3.3.11 Calculating incentive adjustments after a catastrophic event

"Where a price-quality path is amended following a **catastrophic event**, the *forecast opex* and *forecast value of commissioned assets* used to calculate the **amount carried forward** in the **disclosure year** in which the **catastrophic 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**."

6.5 In the **GTB IM Determination**, insert new subpart 8 in Part 4:

"SUBPART 8 – **Incentive Mechanisms**

"4.8.1 Determination of capex incentives

"(1) The Commission will determine the **forecast return**, **forecast depreciation**, and the method for calculating return, for each **disclosure year** of the **DPP regulatory period** for all **assets** forecast to be **commissioned**.

"(2) The Commission will specify the **retention factor** that applies for each **GTB** during the **DPP regulatory period**."

6.6 In the **GTB IM Determination**, delete subclause 5.3.1(a), renumbering subsequent subclauses accordingly.

6.7 In the **GTB IM Determination**, insert new Subpart 8 in Part 5:

"5.8.1 Determination of capex incentives

"(1) The Commission will determine the **forecast return**, **forecast depreciation**, and the method for calculating return, for each **disclosure year** of the current **DPP regulatory period** for all **assets** forecast to be **commissioned**.

"(2) The Commission will specify the **retention factor** that applies for each **GTB** during the **CPP regulatory period**."

7. TRANSPOWER IM AMENDMENTS

7.1 In the **Transpower IM Determination**, insert the following new definitions in clause 1.1.4:

"**opex incentive adjustment** means the amount determined in accordance with clause 3.6.3(2);

"**amount carried forward** means, for any given **disclosure year**, the amount determined in accordance with clause 3.6.2;

7.2 In the **Transpower IM Determination**, delete the definitions for "allowed controllable opex" and "actual controllable opex".

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

"any **opex incentive adjustment** calculated in accordance with clause 3.6.1(2);"

7.4 In the **Transpower IM Determination**, replace subpart 6 of Part 3 with:

"SUBPART 6 **Incremental rolling incentive scheme**

"3.6.1 Calculation of annual incremental rolling incentive scheme recoverable costs

"(1) Subject to subclause (3), **Transpower** must calculate and apply the **opex incentive adjustment** as a recoverable cost for each **disclosure year** of each **regulatory period**.

"(2) **Transpower** must apply the **opex incentive adjustment** commencing in the first full **regulatory period** commencing after the first **disclosure year** for which it has calculated an **amount carried forward**.

"(3) **Transpower** must calculate an **amount carried forward** commencing from the first **disclosure year** commencing after [date of amendment].

"3.6.2 How to calculate the amount carried forward into subsequent disclosure years

"(1) **Transpower** must calculate an 'amount carried forward' in each **disclosure year**, subject to clause 3.6.6.

"(2) The 'amount carried forward' in the **opening year** of a **regulatory period** is calculated in accordance with the formula –

forecast opex – actual opex

"(3) The 'amount carried forward' in all but in all but the **opening year** or last **disclosure year** of a **regulatory period** is calculated in accordance with the formula –

($forecast\ opex_t - actual\ opex_t$) – ($forecast\ opex_{t-1} - actual\ opex_{t-1}$)

where–

t means the **disclosure year** for which the amount carried forward is being calculated

t-1 means the **disclosure year** prior to the **disclosure year** for which the amount carried forward is being calculated

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

"(5) 'Forecast opex' is the amount of **operating expenditure** determined by the **Commission** for the relevant **disclosure year** in an **IPP determination**, as adjusted by the **Commission** for any disparity between the **forecast CPI** and the actual **CPI** under clause [20.1.6] of the **IPP determination**.

"(6) 'Actual opex' is the amount of **operating expenditure** for the relevant **disclosure year** as reported under an **ID determination**.

"3.6.3 How to calculate the opex incentive adjustment to be applied as a recoverable cost

"(1) Each **amount carried forward** determined in accordance with clause 3.6.2 is notionally carried forward, subject to clause 3.6.6, from the **disclosure year** in respect of which it is determined into each of the subsequent 5 **disclosure years**.

"(2) In each of the **disclosure years** after a **regulatory period** into which an **amount carried forward** has been carried pursuant to subclause (1), a net balance (the 'opex incentive adjustment') must be determined by addition of–

"(a) any **amounts carried forward** into that **disclosure year** from a preceding **regulatory period**; and

"(b) any **adjustment amount** determined in accordance with clauses 3.6.4.

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

"(1) The **adjustment amount** must be calculated in the second **disclosure year** of the **regulatory period** in accordance with the formula –

RCP adjustment term 1 + RCP adjustment term 2 – base year adjustment term

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

$$\frac{(\textit{forecast opex}_{t-1} - \textit{actual opex}_{t-1}) - (\textit{forecast opex}_{t-2} - \textit{actual opex}_{t-2})}{(1+\textit{WACC})^4}$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to **Transpower's** current **IPP**

t-1 means the **disclosure year** immediately preceding the current **regulatory period**

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

"(3) The 'RCP adjustment term 1' is calculated in accordance with the formula –

$$\frac{\textit{conditional value} - \textbf{amount carried forward}_{t-2}}{(1+\textit{WACC})^4}$$

where–

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

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

"(4) The 'RCP adjustment term 2' is calculated in accordance with the formula –

conditional value – **amount carried forward**$_{t-2}$

x

$((1- (1+WACC)^{-5}) / WACC)$

x

$(1+WACC)^2$

where–

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

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

"(5) The 'conditional value' is –

"(a) if the **amount carried forward** in the **disclosure year** two years prior to the current **regulatory period** was greater than zero, the greater of –

"(i) nil; or

"(ii) the **amount carried forward** in the **disclosure year** two years prior to the **regulatory period** or the **amount carried forward** in the **disclosure year** two years prior to the **regulatory period** plus the **amount carried forward** in the **disclosure year** prior to the **regulatory period**, whichever is less;

"(b) if the **amount carried forward** in the **disclosure year** two years prior to the **regulatory period** was less than or equal to zero, the lesser of –

"(i) nil; or

"(ii) the **amount carried forward** in the **disclosure year** two years prior to the **regulatory period** or the **amount carried forward** in the **disclosure year** two years prior to the **regulatory period** plus the **amount carried forward** in the disclosure prior to the **regulatory period**, whichever is greater.

"3.6.5 Calculating incentive adjustments after a catastrophic event

"Where a price-quality path is amended following a **catastrophic event**, the *forecast opex* used to calculate the **amount carried forward** in the **disclosure year** in which the **catastrophic 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 **IPP determination**."