

3 October 2019

To:

Transpower New Zealand Limited
Waikoukou
22 Boulcott Street
Wellington 6011

To the attention of: Alison Andrew, Chief Executive

**Notice to supply forecast MAR and forecast SMAR calculations to the
Commerce Commission under section 53ZD(1)(d), (e) and (f) of the
Commerce Act 1986**

Background

1. On 29 August 2019, we (the Commerce Commission – the **Commission**) published a revised draft determination of the Individual Price-Quality Path (**IPP**) that will apply to Transpower New Zealand Limited (**Transpower**) for **RCP3** from 1 April 2020 (the **revised draft IPP determination**).^{1, 2}
2. Amongst other things, the **revised draft IPP determination** sets out our decisions on the approved **base capex allowances** and the **opex allowance** for **RCP3**. The **revised draft IPP determination** also sets out the method by which those allowances, and other amounts, would be combined to both determine the forecast maximum allowable revenue (**forecast MAR**) for each **pricing year** of **RCP3**, and to smooth the annual revenues over **RCP3**.
3. As part of the **IPP** reset for **RCP3**, we published:
 - 3.1 on 12 July 2019, a draft decisions and reasons paper on the incremental rolling incentive scheme (**IRIS**) baseline adjustment term (the **IRIS draft reasons paper**);

¹ [REVISED DRAFT] *Transpower Individual Price-Quality Path Determination 2020* [2019] NZCC [XX], published 29 August 2019.

² Bolding of words in this Notice denotes defined terms. These are set out in the ‘interpretation’ section of this Notice in clause 16.

- 3.2 on 28 August 2019, the Transpower Input Methodologies Amendments Determination 2019 [2019] NZCC 10 (**2019 IM amendments determination**);
- 3.3 on 28 August 2019, a draft decisions and reasons paper on the treatment of operating leases (the **operating leases draft decision**);
- 3.4 on 29 August 2019, our decisions and reasons paper for approved base capital expenditure, **operating expenditure** allowances and quality standards; and
- 3.5 on 11 September 2019, draft amendments to the Transpower Input Methodologies Determination [2012] NZCC 17 (**Transpower IM determination**) and to the Transpower Capital Expenditure Input Methodology Determination 2012 [2012] NZCC 2 (**Capex IM determination**) in respect of the treatment of payments relating to operating leases (the **operating leases draft IM amendments**).

Purpose of this Notice

- 4. We now issue this notice (**Notice**) under section 53ZD(1)(d), (e) and (f) of the Commerce Act 1986 (**Act**) requiring **Transpower** to produce information and perform calculations that will inform our final **IPP** determination for **RCP3**.
- 5. Specifically, the information will inform and assist our function under section 53P of the **Act** in our initial setting of **Transpower's forecast MAR** and **forecast SMAR** for each **pricing year** of **RCP3**.
- 6. The detailed requirements for the requested information in this Notice and the required calculations are specified in Schedules A and B of this Notice.³
- 7. For the purpose of section 53ZD(1)(e) of the **Act**, the **revenue models** we require under clause 6 of Schedule A of this Notice and clause 1 of Schedule B of this Notice are directly relevant to, and will assist us in investigating and in our initial setting of, **Transpower's forecast MAR** and **forecast SMAR** for each **pricing year** of **RCP3**.
- 8. We note that section 103(2) of the **Act** provides that no person shall:
 - 8.1 without reasonable excuse, refuse or fail to comply with a notice under section 53ZD of the **Act**;
 - 8.2 in purported compliance with such a notice, furnish information, or produce a document, or give evidence, knowing it to be false or misleading; or

³ The information requested in this Notice will inform our initial setting of the numbers for Schedule A, Columns 3, 8 and 9 of the final **IPP** determination for **RCP3**. The process for updating the **forecast MAR** and **forecast SMAR** during **RCP3** is specified in clause 30 of the **revised draft IPP determination**, and that will result in updated numbers being determined for Schedule A, Columns 4, 5, 6, 7, 8 and 9 of the final **IPP** determination for **RCP3**, as applicable at the time.

- 8.3 attempt to deceive or knowingly mislead the **Commission** in relation to any matter before it.
9. It is an offence to contravene section 103 of the **Act** and any person who does so is liable on conviction to a fine not exceeding \$100,000 in the case of an individual or \$300,000 in the case of a body corporate.

Date, place and format of responses to this Notice

10. **Transpower** must respond to this Notice in two stages by providing:
- 10.1 Stage 1: calculations in accordance with the requirements in Schedule A, using amounts relating to forecast **opex incentive amounts** under the **IRIS** according to the following two scenarios:
- 10.1.1 for the first scenario, **Transpower** must use our draft decision on the **IRIS 'differences in penultimate year'** set out in the **IRIS draft reasons paper**; and
- 10.1.2 for the second scenario, **Transpower** must use zero as the value for the **IRIS 'differences in penultimate year'**; and
- 10.2 Stage 2: calculations in accordance with Schedules A and B, with an **independent assurance opinion** from an **assurance auditor**.
11. **Transpower** must provide the information required under this Notice for Stage 1 by email not later than 4:30pm on Thursday 10 October 2019.
12. **Transpower** must provide:
- 12.1 the information required under this Notice for Stage 2 by email not later than 4.30pm on Tuesday 25 October 2019; and
- 12.2 a publishable version of the information required under this Notice for Stage 2 by email not later than 4.30pm on Tuesday 12 November 2019.
13. **Transpower** may alternatively respond to the requirement of clause 12.2 by making the information publicly available on **Transpower's** website, and notifying the **Commission** that it has done so. If **Transpower** chooses to make the information required for Stage 2 publicly available on its website, **Transpower** must do so on 14 November 2019, after the **Commission** has published its final decision on the RCP3 IPP determination.
14. Numerical information provided as part of both Stage 1 and Stage 2 of the responses must be provided in Microsoft Excel format, with formulas intact.
15. The emails must be addressed to Dane Gunnell (Manager, Price-Quality Regulation) c/o regulation.branch@comcom.govt.nz, with the subject "Transpower – Response to section 53ZD Notice – forecast MAR and forecast SMAR calculations".

Independent assurance opinion

16. For the information required in Stage 2, along with the information specified in Schedules A and B, we require **Transpower** to provide us with, under section 53ZD(1)(f) of the **Act**, an **independent assurance opinion** from an **assurance auditor** in respect of the information specified in Schedules A and B in accordance with Schedule C.

Interpretation

17. In this Notice, unless the context requires otherwise:
- 17.1 a word that denotes the singular also denotes the plural, and vice versa; and
- 17.2 words in **bold type** have the following meanings:
- 17.2.1 **Act** means the Commerce Act 1986;
- 17.2.2 **assurance auditor** has the meaning set out in the **revised draft IPP determination**;
- 17.2.3 **base capex allowance** has the meaning given in the **Capex IM determination**;
- 17.2.4 **base capex expenditure adjustment** has the meaning given in the **Capex IM determination**;
- 17.2.5 **Capex IM determination** means the *Transpower Capital Expenditure Input Methodology Determination 2012 [2012] NZCC 2*, including amendments in effect at the date of this Notice;
- 17.2.6 **Closing RAB value** has the meaning set out in the **Transpower IM determination**;
- 17.2.7 **Commission** means the Commerce Commission;
- 17.2.8 **commissioned** has the meaning set out in the **Transpower IM determination**;
- 17.2.9 **disclosure year** has the meaning set out in the **Transpower IM determination**;
- 17.2.10 **EV account** has the meaning set out in the **revised draft IPP determination**;
- 17.2.11 **EV account entry** has the meaning set out in the **revised draft IPP determination**;
- 17.2.12 **Forecast EV adjustment** has the meaning set out in the **Transpower IM determination**;

- 17.2.13 **forecast MAR** has the meaning set out in the **revised draft IPP determination**;
- 17.2.14 **forecast MAR building blocks** means the items in Column 1 of Schedule D of the **revised draft IPP determination**;
- 17.2.15 **forecast SMAR** has the meaning set out in the **revised draft IPP determination**;
- 17.2.16 **HVAC** has the meaning set out in the **revised draft IPP determination**;
- 17.2.17 **HVDC** has the meaning set out in the **revised draft IPP determination**;
- 17.2.18 **independent assurance opinion** means the opinion required under Schedule C of this Notice;
- 17.2.19 **IPP** means individual price-quality path;
- 17.2.20 **IPP revenue growth rate** has the meaning set out in the **revised draft IPP determination**;
- 17.2.21 **IRIS** has the meaning set out in the **revised draft IPP determination**;
- 17.2.22 **ISAE 3000 (NZ) (Revised)** means the International Standard on Assurance Engagements 3000 (New Zealand) (Revised);
- 17.2.23 **opening RAB value** has the meaning given in the **Transpower IM determination**;
- 17.2.24 **operating expenditure** has the meaning given in the **Transpower IM determination**;
- 17.2.25 **opex allowance** has the meaning given in the **revised draft IPP determination**;
- 17.2.26 **pass-through costs** has the meaning given in the **Transpower IM determination**;
- 17.2.27 **pricing year** has the meaning given in the **Transpower IM determination**;
- 17.2.28 **RCP2** has the meaning set out in the **revised draft IPP determination**;
- 17.2.29 **RCP2 IPP determination** means the *Transpower Individual Price-Quality Path Determination 2015* [2014] NZCC 35, incorporating all amendments as at 26 November 2018;

- 17.2.30 **RCP3** has the meaning set out in the **revised draft IPP determination**;
- 17.2.31 **recoverable cost** has the meaning given in the **Transpower IM determination**;
- 17.2.32 **revenue model** means the revenue model **Transpower** uses to calculate its **forecast MAR** and **forecast SMAR**;
- 17.2.33 **SAE 3100 (Revised)** means the Standard on Assurance Engagements 3100 - Compliance Engagements (Revised);
- 17.2.34 **Transpower** means Transpower New Zealand Limited;
- 17.2.35 **Transpower IM determination** means the *Transpower Input Methodologies Determination 2010* [2012] NZCC 17, including amendments in effect at the date of this Notice; and
- 17.2.36 **WACC** means—
- (a) for the purpose of calculating a **forecast MAR**, the 67th percentile estimate of vanilla weighted average cost of capital determined by the **Commission** in accordance with clause 3.5.5(1) of the **Transpower IM determination**; and
 - (b) for the purpose of calculating the **forecast SMAR**, the 67th percentile estimate of post-tax weighted average cost of capital determined by the **Commission** in accordance with clause 3.5.5(2) of the **Transpower IM determination**.

Use of supplied information and confidentiality

18. As part of our decision making and modelling for the **IPP** reset, we may publish, use and publicly refer to particular information **Transpower** provides in responding to this Notice.
19. If **Transpower** considers that, for confidentiality reasons, we should not publish or publicly refer to any particular part of its response, **Transpower** must:
- 19.1 specify the relevant part;
 - 19.2 give clear reasons why **Transpower** considers that part is confidential; and
 - 19.3 provide a PDF version of the response, redacting the part(s) **Transpower** considers to be confidential.
20. If **Transpower** indicates that we should not publish or publicly refer to part of its response, we may consult with **Transpower** before deciding whether or not to do so.

21. However, please note that all responses we receive, including any parts that we decide not to publish, can be requested under the Official Information Act 1982. This means we would be required to release material (whether published or not) unless good reason existed under the Official Information Act 1982 to withhold it. We would normally consult before releasing any material that **Transpower** requests not to be published.

Dated at Wellington: 3 October 2019

Signed by:



Sue Begg
Commissioner

Schedule A: forecast MAR and forecast SMAR calculations

Forecast EV account balance at the end of RCP2

1. Under section 53ZD(1)(d) of the **Act**, and in accordance with clause 2 of this Schedule, **Transpower** must provide a forecast of the balance of its **EV account** in total and also broken down into each of its **HVAC** and **HVDC EV accounts** as at the end of the last **disclosure year** of **RCP2** (that is, including any forecast wash-up amounts for that **disclosure year**), taking into account the **EV account entry** resulting from the wash-up amount for the 2018/19 **disclosure year**.
2. When forecasting the balance of the **EV account** at the end of the last **disclosure year** of **RCP2**, **Transpower** must separately identify the **RCP3** revenue effect attributable to the change in the **base capex expenditure adjustment** from applying on a '**commissioned**' basis in **RCP2** to applying on an 'expenditure' basis in **RCP3**.

Calculation of forecast EV adjustment amounts

3. Under section 53ZD(1)(d)(i) of the **Act**, **Transpower** must prepare and produce **forecast EV adjustments** for **RCP3**.
4. To provide the **Commission** with visibility of the composition of the **forecast EV adjustments** **Transpower** must also provide a breakdown of the totals into each of **Transpower's HVAC** and **HVDC EV accounts**.

Calculation of forecast MAR and forecast SMAR

5. Under section 53ZD(1)(d) of the **Act**, for each **pricing year** in **RCP3**, **Transpower** must provide:
 - 5.1 the **forecast MAR**, calculated in accordance with clause 7 of Schedule A; and
 - 5.2 the **forecast SMAR**, calculated in accordance with clause 8 of Schedule A.
6. Under section 53ZD(1)(e)(i) of the **Act**, **Transpower** must provide to the **Commission** a copy of its **revenue model** used to generate the **forecast MAR** and **forecast SMAR** amounts.
7. In calculating the **forecast MAR**, **Transpower** must:
 - 7.1 apply:
 - 7.1.1 except as specified in clause 5.2 of this Schedule, the **forecast MAR building blocks**;
 - 7.1.2 the input methodologies in the **Transpower IM determination**, as applicable;
 - 7.1.3 the input methodology in the **Capex IM determination**, as applicable;

- 7.1.4 an estimated sum of **opening RAB values** for **RCP3** that takes into account the actual sum of **closing RAB values** in the 2018/19 **disclosure year**; and
- 7.1.5 the 67th percentile estimate of vanilla **WACC**;
- 7.2 meet the following requirements:
- 7.2.1 advise whether any update to the forecast amounts of **pass-through costs** and **recoverable costs** is needed, and if updates are needed, **Transpower** must use the updated amounts and notify the **Commission** of the current forecast amounts and the **disclosure year(s)** to which they relate. The square bracketed numbers for forecast **pass-through costs** and forecast **recoverable costs** in clause 30.2(j) and (k) of the **revised draft IPP determination** reflect the amounts originally provided by **Transpower** in its RM01 Revenue Model, with adjustments to reflect the treatment of the Fire and Emergency New Zealand levy and the levy paid to the Energy Complaints Scheme operated by Utilities Disputes Limited;
- 7.2.2 apply the treatment as though the **operating leases draft IM amendments** were in force, when accounting for payments relating to operating leases, including the identified tax treatment. In our **operating leases draft decision** and **operating leases draft IM amendments**, we set out how we proposed payments relating to operating leases would be treated for the purposes of setting **Transpower's** price path; and
- 7.2.3 for the purposes of the **operating expenditure** allowance used in the **forecast MAR building blocks**, the **opex allowance** amounts specified in clause 29.1.6 of the **revised draft IPP determination**, as set out in Table 1 below.

Table 1: Opex allowance

Disclosure Year	1 July 2020 to 30 June 2021	1 July 2021 to 30 June 2022	1 July 2022 to 30 June 2023	1 July 2023 to 30 June 2024	1 July 2024 to 1 June 2025
Opex allowance (\$m)	271.5	276.0	286.0	295.6	295.9

8. In calculating the **forecast SMAR** amount for each **pricing year** of **RCP3**, **Transpower** must use:
- 8.1 the method described in clause 3.1.1 of the **Transpower IM determination**;
- 8.2 the **forecast MAR** calculated under clause 7 of this Schedule A; and

- 8.3 the **IPP revenue growth rate**. The square bracketed number in clause 8.4 of the **revised draft IPP determination** reflects the forecast revenue and simplifying assumptions used at that time. **Transpower** must advise if an update to this number is required, and if an update is required, **Transpower** must use the updated number and notify the **Commission** of the updated value.

Schedule B: Revenue model with IRIS baseline adjustment term decision incorporated

1. Under section 53ZD(1)(e)(i) of the **Act**, for Stage 2 **Transpower** must provide to the **Commission** a version of its **revenue model**, being the same as that described in clause 6 of Schedule A of this Notice, with the following modifications:
 - 1.1 use of the forecast value for the **IRIS** baseline adjustment term as a forecast **recoverable cost** consistent with the approach used by the **Commission** to set the projected **IRIS** baseline adjustment term to be advised to **Transpower** on or about 18 October 2019; and
 - 1.2 changes to the **revenue model** (compared to the **revenue model** described in clause 6 of Schedule A of this Notice) that result from changing the value of the **IRIS** baseline adjustment term under clause 1.1 of this Schedule, such as automatic updates to other values that depend on this term (eg, total forecast **recoverable cost** amounts), or as a consequence of macros for tax calculations or revenue smoothing.
2. If **Transpower** makes any additional changes to the **revenue model** described in clause 6 of Schedule A of this Notice, **Transpower** must indicate what these changes are.

Schedule C: independent assurance opinion

1. Under section 53ZD(1)(f) of the **Act**, **Transpower** must procure and provide to the **Commission** an **independent assurance opinion** from an **assurance auditor** in respect of the calculations and information required under Schedules A and B of this Notice that:
 - 1.1 is prepared in accordance with the **SAE 3100 (Revised)** and the **ISAE (NZ) 3000 (Revised)** or their successor standards, signed by the **assurance auditor**, either in his or her own name or that of his or her firm;
 - 1.2 is addressed to the directors of **Transpower**; and
 - 1.3 states:
 - 1.3.1 that it has been prepared in accordance with **SAE 3100 (Revised)** and **ISAE (NZ) 3000 (Revised)** or their successor standards;
 - 1.3.2 the work done by the **assurance auditor**;
 - 1.3.3 the scope and limitations of the assurance engagement;
 - 1.3.4 the existence of any relationship (other than that of **assurance auditor**) which the **assurance auditor** has with, or any interests which the **assurance auditor** has in, **Transpower** or any of its subsidiaries;
 - 1.3.5 whether the **assurance auditor** has obtained sufficient recorded information and explanations that he or she required and, if not, the information and explanations not obtained;
 - 1.3.6 whether, in the **assurance auditor's** opinion, as far as appears from an examination of them, proper records to enable the complete and accurate compilation of the **forecast MAR** and **forecast SMAR** calculations have been kept by **Transpower** and, if not, the records not so kept;
 - 1.3.7 whether in the **assurance auditor's** opinion, as far as appears from the examination, the information used in the preparation of the **forecast MAR** and **forecast SMAR** calculations has, where applicable, been properly extracted from **Transpower's** accounting and other records, sourced from its financial and non-financial systems; and
 - 1.3.8 whether in the **assurance auditor's** opinion, **Transpower** has complied, in all material respects, with this Notice in preparing the **forecast MAR** and **forecast SMAR** calculations and supporting information and, if not, the respects in which **Transpower** has not done so.