

Guidance note for calculating Transpower's MAR wash ups

Purpose

1. Transpower New Zealand Limited (Transpower) is required to annually provide the Commerce Commission (Commission) with its calculation of the after-tax ex-post economic gain or loss for each disclosure year in a regulatory period.¹ We refer to this calculation as the MAR wash up.
2. We have developed this guidance note for Transpower in response to issues it has identified in earlier MAR wash up processes. The note draws on previous responses agreed with by Transpower and complements the accompanying information gathering notice issued under section 53ZD of the Commerce Act 1986.
3. In particular, this note provides guidance on:
 - 3.1 the sources and application of data to the building blocks used in calculation of the ex-post economic gains or losses for RCP1; and
 - 3.2 the Commission's application of relevant regulatory requirements in the calculation of the MAR wash up.
4. Transpower must comply with all relevant regulations when calculating MAR wash ups, in particular the IPP Determination and the applicable input methodologies in the IM Determination and the Capex IM Determination.² This note is not intended to be a substitute for legal advice and has no legal standing. For the avoidance of doubt this note does not replace or amend any compliance obligation on Transpower.
5. The ex-post economic gain or loss is applied as an entry in Transpower's EV account and is used to make EV adjustments in calculating the updated forecast MAR for subsequent years. Transpower's price path is the updated forecast MAR determined by the Commission, which takes into account Transpower's draft calculation.

Interpretation

Unless the context otherwise requires, defined terms in this note have the meaning as specified in the IPP Determination.

¹ The requirement is under clause 5.2(6) of the Commerce Act (Transpower Individual Price-Quality Path) Determination 2010 (IPP Determination), including all amendments to 31 October 2012.

² Commerce Commission, *Commerce Act (Transpower Input Methodologies) Determination*, 22 December 2010, amended by the *Commerce Act (Transpower Input Methodologies) Amendment Determination (No.1) 2011*, 1 November 2011, and Commerce Commission, *Re Transpower Capital Expenditure Input Methodology Determination [2012] NZCC 2*, 31 January 2012.

Calculation of MAR wash ups

Methodology for calculating each annual MAR wash up applied to the EV account

6. Transpower is required to prepare a MAR wash up calculation for each disclosure year in RCP1 in the format specified in Schedule E of the IPP Determination. This is carried out by applying each formula identified in the attached Appendix 1 (see Schedule E of the IPP Determination v1.2, as amended and consolidated at 31 October 2012).
7. In order to carry out the MAR wash up calculations Transpower will follow steps which include those illustrated in the attached Appendix 1, adopt the input methodologies described in attached Appendix 2, and apply necessary modifications to the input methodologies as described in attached Appendix 2.
8. Under the IPP Determination, Transpower must use applicable values in the MAR wash up calculations, which we have summarised in the attached Appendix 3. The sources of the respective requirements to use these values are noted in the attached Appendix 3.

Calculating other revenue adjustments that are applied to the EV account

9. In RCP1 the 'major capex adjustments' calculated under the Capex IM Determination are made as 'EV account entries' and are included in the EV adjustments separately from the MAR wash up.
10. There is no revenue adjustment for base capex under the Capex IM Determination in RCP1. All revenue adjustments for minor capital expenditure in RCP1 are instead specified in the IPP Determination.

Appendix 1: MAR Wash Up Building Blocks Calculation RCP1 (Refer to Schedule E of IPP Determination v1.2)

1. This Appendix 1 maps the building block calculation set out in Schedule E of the IPP Determination to the inputs used in order to calculate the MAR wash up for each disclosure year in RCP1.
2. Reported values are rounded to the nearest \$100,000 and are expressed as \$X.XM.

MAR WASH UP BUILDING BLOCK	FORMULA	INPUTS TO THE MAR WASH UP FORMULA
Opening RAB value	M1	Opening RAB value, calculated under Section A of attached Appendix 2.
Commissioned value of approved capital expenditure	M2	Weighted value of commissioned assets, calculated under Section B of attached Appendix 2.
RAB	$M = M1 + M2$	RAB, calculated under Section C of attached Appendix 2 (refer to the IPP Determination, Schedule E, Formula M).
WACC	N	WACC, for every disclosure year, as noted in attached Appendix 3 (refer to the IPP Determination, Schedule E).
Capital charge	$O = M \times N$	RAB multiplied by WACC, calculated under Section D of attached Appendix 2 (refer to the IPP Determination, Schedule E, Formula O).
Operating revenue	P	Operating revenue, calculated under Section E of attached Appendix 2 (refer to the IPP Determination, Schedule E, Formula P).
Operating expenditure	E	Operating expenditure allowance, for each disclosure year, as noted in attached Appendix 3 (refer to the IPP Determination, Schedule E, Formula E).
Term credit spread differential	Q	Term credit spread differential allowance, calculated under Section F of attached Appendix 2 (refer to the IPP Determination, Schedule E, Formula Q).
Depreciation	R	Depreciation, calculated under Section G of attached Appendix 2 (refer to the IPP Determination, Schedule E, Formula R).
Net operating profit before tax	$S = P - E - Q - R$	Pre-tax profit for regulatory purposes, calculated under Section H of attached Appendix 2 (refer to the IPP Determination, Schedule E, Formula S).
Tax	T	Regulatory tax allowance, calculated under Section I of attached Appendix 2 (refer to the IPP Determination, Schedule E, Formula T).
Net operating profit after tax	$U = S - T$	After-tax profit for regulatory purposes, calculated under Section J of attached Appendix 2 (refer to the IPP Determination, Schedule E, Formula U).

MAR WASH UP BUILDING BLOCK	FORMULA	INPUTS TO THE MAR WASH UP FORMULA
EV account entry	Formula V = O-U	This is the after-tax ex-post economic gain or loss, calculated under Section L of attached Appendix 2 (refer to the IPP Determination, Schedule E, Formula V).

Appendix 2: Applying IPP Determination, IM Determination and Capex IM Determination to the MAR Wash Ups

1. This Appendix sets out the calculations and relevant input methodologies applied, with necessary modifications (as allowed in the input methodologies), in order to calculate the MAR wash ups for each relevant disclosure year in RCP1 in accordance with attached Appendix 1.
2. Reported values are rounded to the nearest \$100,000 and are expressed as \$X.XM.

SPECIFIED VALUE	THE MAR WASH UP BUILDING BLOCK WHERE THE VALUE IS USED	HOW IPP AND IM DETERMINATIONS ARE TO BE APPLIED	VALUE CALCULATED
Section A: Calculating the opening RAB value			
(1) Opening RAB value for the disclosure year ending 30 June 2012 (Transition Year)	Used to calculate the RAB for the disclosure year. The RAB is used to calculate the capital charge and depreciation building blocks.	The opening RAB value for the 2011/12 disclosure year is specified in clause 2.2.3(3)(a) of the IM Determination as the initial RAB value. The opening RAB value may not include any amounts relating to operating leases that were capitalised to the RAB under the terms of the Thresholds Notice in assessment years prior to the first disclosure year of RCP1. The opening RAB value is applied in calculating the RAB in accordance with the IPP Determination, Schedule E, Formula M.	
(2) Closing RAB value for the disclosure year ending 30 June 2012 (Transition Year)	Used to calculate the RAB for the 2012/13 disclosure year.	The closing RAB value for the disclosure year is calculated in accordance with the opening RAB value for the disclosure year and clauses 2.2.3(4) and 3.3.1 of the IM Determination, and including any necessary modifications specified in this Section A, (5) to (7) below.	
(3) Opening RAB value for a disclosure year in the Remainder Period	Used to calculate the RAB for the disclosure year. The RAB is used to calculate the capital charge and depreciation building blocks.	The opening RAB value for the disclosure year is the closing RAB value for the previous disclosure year in accordance with 2.2.3(3)(b) of the IM Determination. The opening RAB value is applied in calculating the RAB in accordance with the IPP Determination, Schedule E, Formula M.	

SPECIFIED VALUE	THE MAR WASH UP BUILDING BLOCK WHERE THE VALUE IS USED	HOW IPP AND IM DETERMINATIONS ARE TO BE APPLIED	VALUE CALCULATED
(4) Closing RAB value for a disclosure year in the Remainder Period	Used to calculate the RAB for the following disclosure year.	The closing RAB value for the disclosure year is calculated in accordance with the opening RAB value for the disclosure year and clauses 2.2.3(4) and 3.3.1 of the IM Determination, and including any necessary modifications specified in this Section A, (5) to (7) below.	
(5) Allowed 'necessary modification' to asset valuation input methodology to calculate the closing RAB value for each disclosure year	Used to calculate the opening RAB value for the following disclosure year.	In accordance with clause 2.2.6(1)(h) of the IM Determination, a weighted average remaining asset life may be applied for the purposes of clause 2.2.4 of the IM Determination where capital expenditure on a project that is commissioned during the disclosure year comprises a combination of asset descriptions and where the mix of the capital expenditure within the project is required to be estimated.	
(6) Allowed 'necessary modification' to asset valuation input methodology to calculate the closing RAB value for each disclosure year	Used to calculate the opening RAB value for the following disclosure year.	Dismantling costs that are not included in the opening RAB value for the 2011-12 disclosure year may be included in 'depreciation' for each disclosure year that the expenditure on such dismantling costs is incurred.	
(7) Allowed 'necessary modification' to asset valuation input methodology to calculate the closing RAB value for each disclosure year	Used to calculate the opening RAB value for the following disclosure year.	The depreciation for the purpose of calculating the closing RAB value for a disclosure year is calculated taking into account depreciation on pseudo assets as defined in the Thresholds Notice and as noted in attached Appendix 3 (see clause 2.2.6(1)(g) of the IM Determination).	
Section B: Calculating the weighted value of commissioned assets			
(1) Value of commissioned assets for a disclosure year	The value of commissioned assets is used to calculate the weighted value of commissioned assets for the disclosure year.	The value of commissioned assets is calculated by applying GAAP to each asset in accordance with clause 2.2.7 of the IM Determination and then applying the cost allocation process in accordance with clause 2.1.1 of the IM Determination. Capital expenditure on system operator tool upgrades is allocated to system operator services.	
(2) Weighted value of commissioned assets for a disclosure year	The weighted value of commissioned assets is used to calculate the RAB for the disclosure year for the purposes of the capital charge.	The value of each asset is weighted according to the time of commissioning during the disclosure year in accordance with the IPP Determination, Schedule E, Formula M.	

SPECIFIED VALUE	THE MAR WASH UP BUILDING BLOCK WHERE THE VALUE IS USED	HOW IPP AND IM DETERMINATIONS ARE TO BE APPLIED	VALUE CALCULATED
Section C: Calculating the Average RAB value for the capital charge			
(1) RAB for a disclosure year	The RAB value is a MAR wash up building block used to calculate the capital charge for the disclosure year.	The opening RAB value for the disclosure year (see Section A above) is summed with the weighted value of commissioned assets for the disclosure year (see Section B above) to obtain the weighted RAB value in accordance with the IPP Determination, Schedule E, Formula M. Note that no account is taken of depreciation in the disclosure year in setting the RAB value for this purpose.	
Section D: Calculating the capital charge			
(1) Capital charge for a disclosure year	The capital charge is a MAR wash up building block that is calculated for the disclosure year as the product of the RAB and the WACC for the disclosure year.	The capital charge is specified by Formula O of Schedule E of the IPP Determination. It is calculated by multiplying the result of the IPP Determination, Schedule E, Formula M (see Section C above) by the IPP Determination, Schedule E, Formula N (Vanilla WACC rate noted in attached Appendix 3).	
Section E: Calculating the operating revenue			
(1) Operating revenue for a disclosure year	The operating revenue is a MAR wash up building block.	The operating revenue in the IPP Determination, Schedule E, Formula P comprises the sum of the HVAC revenue and the HVDC revenue for the disclosure year calculated in accordance with the IPP Determination, Schedule E, Formula P. The HVAC revenue and HVDC revenue are defined in Part 2 of the IPP Determination and they exclude pass through costs and recoverable costs passed on to customers in the disclosure year.	
Section F: Calculating the term credit spread differential allowance			
(1) Term credit spread differential for a disclosure year	The term credit spread differential allowance for the disclosure year is a MAR wash up building block.	The term credit spread differential allowance in the IPP Determination, Schedule E, Formula Q, if applicable to the disclosure year, is to be calculated in accordance with clause 3.5.10 of the IM Determination, with 'qualifying supplier' in clause 3.5.10(3) of the IM Determination being taken to refer to Transpower, and with 'leverage' in clause 3.5.10(3)(c) of the IM Determination being 44%.	

SPECIFIED VALUE	THE MAR WASH UP BUILDING BLOCK WHERE THE VALUE IS USED	HOW IPP AND IM DETERMINATIONS ARE TO BE APPLIED	VALUE CALCULATED
Section G: Calculating the depreciation charge			
(1) Unallocated depreciation for the purposes of calculating the closing RAB value for a disclosure year	Used to calculate the opening RAB value for the following disclosure year.	The unallocated depreciation for the purposes of calculating the closing RAB value for the disclosure year is the amount calculated in accordance with clauses 2.2.4 and 3.3.1 of the IM Determination.	
(2) Depreciation for a disclosure year	The depreciation is a MAR wash up building block and is used to calculate the opening RAB value for the following disclosure year.	The depreciation in the IPP determination, Schedule E, Formula R for the disclosure year is the amount calculated in accordance with clauses 2.1.1, 2.2.4 and 3.3.1 of the IM Determination and including the 'necessary modifications' specified in this Section G, (3) to (5) below.	
(3) Allowed 'necessary modification' to asset valuation input methodology to calculate the depreciation for each disclosure year	Used to calculate the depreciation for the disclosure year.	In accordance with clause 2.2.6(1)(h) of the IM determination, a weighted average remaining asset life may be applied for the purposes of clause 2.2.4 of the IM determination where capital expenditure on a project that is commissioned during the disclosure year comprises a combination of asset descriptions and where the mix of the capital expenditure within the project is required to be estimated.	
(4) Allowed 'necessary modification' to asset valuation input methodology to calculate the depreciation for each disclosure year	Used to calculate the depreciation for the disclosure year.	Dismantling costs that they are not included in the opening RAB value for the disclosure year ending 30 June 2012 may be included in depreciation for the year such dismantling costs are incurred.	
(5) Allowed 'necessary modification' to asset valuation input methodology to calculate the closing RAB value for each disclosure year	Used to calculate the depreciation for the disclosure year.	The depreciation is calculated taking into account depreciation on pseudo assets as defined in the Thresholds Notice and as noted in attached Appendix 3 (see clause 2.2.6(1)(g) of the IM Determination).	

SPECIFIED VALUE	THE MAR WASH UP BUILDING BLOCK WHERE THE VALUE IS USED	HOW IPP AND IM DETERMINATIONS ARE TO BE APPLIED	VALUE CALCULATED
Section H: Calculating the net operating profit before tax			
(1) Net operating profit before tax for a disclosure year	The net operating profit before tax is a MAR wash up building block.	The net operating profit before tax is specified by the IPP Determination, Schedule E, Formula S. It is calculated by deducting from the operating revenue for the disclosure year the operating expenditure for the disclosure year, the term credit spread differential allowance for the disclosure year, and the depreciation for the disclosure year.	
Section I: Calculating the regulatory tax allowance			
(1) Tax calculation for a disclosure year	The regulatory tax allowance for the disclosure year is a MAR wash up building block.	The regulatory tax allowance for the disclosure year in the IPP Determination, Schedule E, Formula T is calculated in accordance with clause 3.4.1 of the IM Determination, with necessary modifications as determined and disclosed by Transpower. In particular, the regulatory profit/loss before tax is calculated in accordance with this Section I, (2) below.	
(2) Regulatory profit/loss before tax under the tax rules for a disclosure year	The regulatory tax allowance is calculated by applying the corporate tax rate to the regulatory profit/loss before tax calculated under the tax rules.	The phrases 'as specified by the Commission' in clause 3.4.1(2) of the IM determination and 'in accordance with an ID Determination' in clause 2.3.1(2) of the IM Determination mean that, unless specified otherwise in this Appendix 2, the 'regulatory profit/loss before tax' under the tax rules is calculated in accordance with clause 2.3.1(3) of the IM Determination using values that are consistent with values used in other MAR wash up building blocks.	
(3) Tax deductible operating expenditure for a disclosure year	The regulatory profit/loss before tax under the tax rules for the regulatory tax allowance is calculated by taking into account the tax deductible operating expenditure.	The 'regulatory profit/loss before tax' under the tax rules for the disclosure year is calculated using Transpower's total operating expenditure allocated to activities undertaken by Transpower to supply electricity transmission services for the disclosure year that would be tax deductible under the tax rules.	
(4) Notional interest deduction for a disclosure year	The regulatory profit/loss before tax under the tax rules for the regulatory tax allowance is calculated by taking into account a notional deduction for tax deductible interest.	The 'notional deductible interest' for the disclosure year under clause 2.3.1(3)(a) of the IM Determination is calculated in accordance with clause 2.3.1(4) of the IM Determination, and with 'leverage' in clause 2.3.1(4) of the IM Determination being 44%.	

SPECIFIED VALUE	THE MAR WASH UP BUILDING BLOCK WHERE THE VALUE IS USED	HOW IPP AND IM DETERMINATIONS ARE TO BE APPLIED	VALUE CALCULATED
(5) Tax depreciation deduction for a disclosure year	The regulatory profit/loss before tax under the tax rules for the regulatory tax allowance is calculated by taking into account a deduction for depreciation calculated under the tax rules.	The tax deduction for depreciation for the disclosure year under clause 2.3.1(3)(b) of the IM Determination is to be calculated in accordance with clause 2.3.1(3)(b) of the IM Determination and the regulatory asset value calculated in accordance with clause 2.3.2 of the IM Determination.	
Section J: Calculating the net operating profit after tax			
(1) Net operating profit after tax for a disclosure year	The net operating profit after tax is a MAR wash up building block.	The net operating profit after tax is specified by the IPP Determination, Schedule E, Formula U. It is calculated by deducting the regulatory tax allowance for the disclosure year from the net operating profit before tax for the disclosure year.	
Section K: Calculating the major capex adjustments (with effect from 31 January 2012)			
(1) Major capex adjustments total for a disclosure year	The major capex adjustments are EV account entries.	This is the sum of the major capex adjustments specified in the definition of 'major capex adjustments' in the IPP Determination, Part 2. It is calculated for the disclosure year by summing the major capex efficiency adjustment (Section K, (2) below) and the major capex output adjustment (Section K, (3) below) for the disclosure year.	
(2) Major capex overspend adjustment for a disclosure year	The major capex overspend adjustment is a component of the major capex adjustments for each disclosure year.	The major capex overspend adjustment is specified for each applicable commissioned asset or project in the Capex IM Determination, Schedule B, Clause B4. The overspend adjustment for the 2011-12 disclosure year takes effect from 31 January 2012, the date of the Capex IM Determination (i.e. part way through the 2011-12 disclosure year). The format for calculation of the major capex overspend adjustment is in attached Appendix 4.	
(3) Major capex output adjustment for a disclosure year	The major capex output adjustment is a component of the major capex adjustments for each disclosure year.	The major capex output adjustment is specified in the Capex IM Determination, Schedule B, Clause B5. The format for calculation of this adjustment is in attached Appendix 5.	

SPECIFIED VALUE	THE MAR WASH UP BUILDING BLOCK WHERE THE VALUE IS USED	HOW IPP AND IM DETERMINATIONS ARE TO BE APPLIED	VALUE CALCULATED
(4) Major capex incentive adjustment for the disclosure year ending 30 June 2015	The major capex incentive adjustment is a component of the major capex adjustment in the final disclosure year.	The major capex incentive adjustment is specified in the Capex IM Determination, Schedule B, Clause B6. It is calculated for RCP1 in aggregate and is applied to the MAR wash up in the final disclosure year of the regulatory period. The format for the calculation of this adjustment is in attached Appendix 6.	
Section L: Calculating EV account entries			
(1) EV account entry for each disclosure year for the ex-post economic gain or loss	The EV account entry is the result of the MAR wash up building block calculations.	The EV account entry is the after-tax ex-post economic gain or loss for the disclosure year. The EV account entry is specified in the IPP Determination, Schedule E, Formula V. It is calculated as the capital charge for the disclosure year (Formula O, see Section D above) less the net operating profit after tax for the disclosure year (Formula U, see Section J above).	
(2) EV account entry for major capital expenditure overspends prior to 31 January 2012 in the disclosure year ending 30 June 2012	The EV account entry is the result of major capital expenditure overspends in excess of the level of expenditure approved by the Commission (or Electricity Commission).	The EV account entry is the NPV of the after-tax revenue effect over the life of applicable assets of major capital expenditure overspends on assets commissioned up to 31 January 2012 as specified in the IPP Determination, Clause 5.3(4)(d)(i) as it applied prior to 31 January 2012.	
(3) EV account entry for aggregate minor capital expenditure overspends for the disclosure year ending 30 June 2015	The EV account entry is the result of minor capital expenditure overspends in excess of the level of aggregate minor capital expenditure allowances approved by the Commission for RCP1.	The EV account entry is the NPV of the after-tax revenue effect over the life of applicable assets of aggregate minor capital expenditure overspends on assets commissioned up to 30 June 2015 as specified in the IPP Determination, Clause 5.3(4)(d) as it applies from 31 January 2012. The minor capital expenditure allowances used to determine if there is an overspend in aggregate are the values described in attached Appendix 3, items 5 to 8.	
(4) EV account entry for minor capital expenditure that has not been fully subject to Transpower's internal approval processes for the disclosure year ending 30 June 2015	The EV account entry is the result of minor capital expenditure commissioned in RCP1 that has not been subject to Transpower's capex approval processes.	The EV account entry is the NPV of the after-tax revenue effect over the life of applicable assets of minor capital expenditure on assets commissioned up to 30 June 2015 that has not been fully subject to Transpower's internal processes for approval of capital expenditure as specified in the IPP Determination, Clause 5.3(4)(d) as it applies from 31 January 2012.	

Appendix 3: Values to be Applied in the MAR Wash Up Building Block Calculation

1. This Appendix 3 sets out values determined by the Commission or determined under the input methodologies (such as the WACC) to be applied by Transpower to the calculations in attached Appendix 1 and Appendix 2 in order to calculate the MAR wash up for each disclosure year. Note: the minor capital expenditure allowance is now commonly referred to as the base capex allowance, but technically that definition does not apply until the base capex allowance for each disclosure year is set for RCP2 in 2014 under the Capex IM Determination.

VALUE APPLIED	SPECIFIED VALUE
1. Operating expenditure allowance for Transpower's disclosure year ending 30 June 2012 (IPP Determination, clause 5.2(7)(i)).	\$248.5 million
2. Operating expenditure allowance for Transpower's disclosure year ending 30 June 2013, to be adjusted for any disparity between the forecast CPI used in setting the allowance and the actual CPI (IPP Determination, clause 5.2(7)(ii)).	\$279.8 million + CPI disparity adjustment
3. Operating expenditure allowance for Transpower's disclosure year ending 30 June 2014, to be adjusted for any disparity between the forecast CPI used in setting the allowance and the actual CPI (IPP Determination, clause 5.2(7)(iii)).	\$281.2 million + CPI disparity adjustment
4. Operating expenditure allowance for Transpower's disclosure year ending 30 June 2015, to be adjusted for any disparity between the forecast CPI used in setting the allowance and the actual CPI (IPP Determination, clause 5.2(7)(iv)).	\$287.9 million + CPI disparity adjustment
5. Minor capital expenditure allowance for Transpower's disclosure year ending 30 June 2012 (IPP Determination, clause 5.3(6)(a)).	\$208.6 million
6. Minor capital expenditure allowance for Transpower's disclosure year ending 30 June 2013, to be adjusted for any disparity between the forecast CPI used in setting the allowance and the actual CPI (IPP Determination, clause 5.3(6)(b)).	\$301.9 million + CPI disparity adjustment
7. Minor capital expenditure allowance for Transpower's disclosure year ending 30 June 2014, to be adjusted for any disparity between the forecast CPI used in setting the allowance and the actual CPI (IPP Determination, clause 5.3(6)(c)).	\$244.9 million + CPI disparity adjustment
8. Minor capital expenditure allowance for Transpower's disclosure year ending 30 June 2015, to be adjusted for any disparity between the forecast CPI used in setting the allowance and the actual CPI (IPP Determination, clause 5.3(6)(d)).	\$278.4 million + CPI disparity adjustment

VALUE APPLIED	SPECIFIED VALUE
9. Pseudo asset depreciation, to be included in the depreciation for all disclosure years in RCP1 (IM Determination, clause 2.2.6(1)(g)).	\$6.4 million
10. The post-tax WACC for all disclosure years in RCP1 (<i>Determination of the Cost of Capital for Services Regulated under Part 4 of the Commerce Act 1986, pursuant to decisions 709, 710, 711, 712 and 713, 3 March 2011</i>).	7.19%
11. The vanilla basis WACC for all disclosure years in RCP1 (<i>Determination of the Cost of Capital for Services Regulated under Part 4 of the Commerce Act 1986, pursuant to decisions 709, 710, 711, 712 and 713, 3 March 2011</i>).	8.05%
12. The corporate tax rate for the disclosure year ending 30 June 2012 (future years to be set in accordance with the corporate tax rate applying for each disclosure year in the Income Tax Act 2007).	28%
13. The major capex incentive rate for all disclosure years in RCP1 (IPP Determination, clause 5.2(9), as amended to reflect the issue of the Capex IM Determination).	33%

Appendix 4: Major Capex Overspend Adjustment (Refer to Capex IM Determination, Schedule B, Clause B4)

1. This Appendix 4 sets out values which will be applied in calculating a major capex overspend adjustment. The calculation substantially replicates the forecast MAR calculation specified in the IPP Determination. However, in order to derive the present value of the revenue impact of a capex overspend, it is not necessary to include the operating expenditure and EV adjustment building blocks, as these revenue building blocks are not impacted by the capex overspend.

CALCULATION	TERM	SOURCE
Commissioned value of assets in excess of approved major capex	A	Value of commissioned assets as specified in the IM Determination (<i>excess capex impact</i>)
WACC	B	WACC in attached Appendix 3, Item 11 (<i>no change</i>)
Capital charge	$C = A \times B$	RAB multiplied by WACC (<i>annual excess capex impact</i>)
Term credit spread differential	D	Term credit spread differential allowance as specified in the IPP Determination, Schedule D, Formula D (<i>annual excess capex impact</i>)
Depreciation	F	Depreciation as specified in the IPP Determination, Schedule D, Formula F (<i>annual excess capex impact</i>)
Tax	G	Regulatory tax allowance as specified in the IPP Determination, Schedule D, Formula G (<i>annual excess capex impact</i>)
Pre-tax revenue impact	annual revenue impact = $C+D+F+G$	Forecast MAR impact calculated in accordance with the IPP Determination, Schedule D, Formula I (<i>annual excess capex impact</i>)
Corporate tax rate	tax rate	Forecast corporate tax rate as specified in the IM Determination
After-tax revenue impact	(annual revenue impact) $\times (1 - \text{tax rate})$	The annual after-tax revenue impact of the excess major capex
Number of years in the life of the asset	n	Overspend adjustment to be performed for each class of assets with a different asset life n
Present value of after-tax revenue impact (MCOSA)	PV of annual after-tax revenue impact	The present value amount necessary to fully offset the after-tax revenue impact of the excess major capex over the life of the asset in accordance with the Capex IM Determination, Schedule B, Clause B4 (for calculations, refer to Microsoft Excel formula = $PV(WACC, n, \text{annual after-tax revenue impact})$)

Appendix 5: Major Capex Project Output Adjustment (Refer to Capex IM Determination, Schedule B, Clause B5)

CALCULATION	TERM	SOURCE
Major capex incentive rate	s	See attached Appendix 3
Aggregate capital expenditure in respect of a major capex project that does not deliver the approved major capex grid outputs	t	Refer to s 53ZD notice of 23 February 2012 (for 2011-12) and, subject to consultation, the ID Determination (for 2012-13 and later disclosure years)
Major capex project output adjustment (MCPOA)	$MCPOA = s*t$	Capex IM Determination, Schedule B, Clause B5

Appendix 6: Major Capex Efficiency Adjustment (Refer to Capex IM Determination, Schedule B, Clause B7)

CALCULATION	TERM	SOURCE
Major capex incentive rate	u	See attached Appendix 3
Major capex efficiencies	v	ID Determination or a s 53ZD notice, as applicable (2014/15) – calculated at Transpower's application after completion of RCP1
Major capex efficiency adjustment (MCEA)	$MCEA = u*v$	Capex IM Determination, Schedule B, Clause B7

Appendix 7: Guidance Provided to Transpower on the 2012/13 Wash-Up

Modification and date of response	Commission Response
<p>Interest during construction 11/6/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. For the purposes of calculations in the 2012/13 MAR wash up, you should use the GAAP interest rate in your fixed asset records and then manually adjust the total RAB value calculated by your fixed asset records in order to calculate the correct RAB value for price-quality path purposes as at 30 June 2013. 2. In the MAR wash up for 2012-13, we will reduce the regulatory depreciation calculated in your fixed asset records by a single adjustment amount, which will approximate the correct regulatory depreciation. We have agreed to use this approach based on the materiality of the IDC difference estimated for 2011-12. 3. We will require a similar test of the materiality of the adjustment to the fixed asset records for 2012/13 before we apply this approach.
<p>Write-off of network spares 13/7/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. Network spares have no RAB value when purchased (clause 2.2.7(1)(e)). The RAB value only needs to be considered if the spare is later applied to a project or existing asset. 2. Network spares have no depreciation unless they are depreciated for GAAP purposes (clause 2.2.4(3)(a)(iii)). 3. This means that if a network spare is written off for GAAP purposes, depreciation can then apply. But as the physical asset life is effectively nil and there is no provision for this in the general rules in clause 2.2.6, the catch-all clause that requires an engineer's report (clause 2.2.6(1)(h)(iii)) would apply.
<p>Material variation of base capex and opex 23/8/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. We consider that the 1% revenue level is also appropriate guidance on the 'material variation' level for the purposes of commenting on variations between actual and forecast Opex and Minor capex.
<p>Tax asset 12/9/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. The treatment of taxation in the price path (including the MAR wash-ups) is specified in the Treatment of taxation IM in clause 3.4.1(1) of the Transpower IMs, which refers to Subpart 3 of Part 2 of the IMs. 2. In calculating the regulatory profit/(loss) before tax, clause 2.3.1(3)(b) of the IMs allows a tax deduction for depreciation based on the regulatory tax asset value. This value is specified by clause 2.3.2(1) by a formula that applies the tax asset value and the allocation ratio. 3. The tax asset value is defined for most purposes in clause 2.3.2(2)(b) as its adjusted tax value (clause 2.3.2(2)(a) applies only to assets acquired from another regulated supplier or a related party, which we assume is not generally the case for Transpower). 4. The adjusted tax asset value is defined in clause 2.3.2(3)(b) as having the same

	<p>meaning as in the tax depreciation rules (ie, the Income Tax Act 2007 and the rules used by the IRD in applying that Act).</p> <ol style="list-style-type: none"> 5. Based on this, we interpret the IMs to mean that the tax asset value is the same as the tax book value used for tax return purposes, and the regulatory tax asset value is that value adjusted for any cost allocation to activities other than electricity transmission services. 6. This is consistent with the guidance provided by the Commission (see Guide to the MAR wash-ups, Appendix 2, Section I(5)).
<p>Depreciation lives 12/9/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. The general rule for any assets held at 30 June 2011 that become part of the initial RAB value and that would otherwise become fully depreciated in RCP1 are deemed to have a physical asset life of 4 years (applying clause 2.2.6(2) of the IMs). Those assets will become fully depreciated on 30 June 2015 unless disposed of prior. 2. Under that general rule, the depreciation calculations in clauses 2.2.4(1) and (2) will apply. 3. Clause 2.2.4(3)(b) will only apply to an asset if it is disposed of in a disclosure year or if its physical life ends in the year ending 30 June 2015 in accordance with clause 2.2.6(2)). 4. For background on this, refer to paragraph 4.4.140 of the IM Reasons Paper of December 2010.
<p>Depreciation spreading adjustment 12/9/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. In terms of the definition of MAR in the IPP, all cost amounts (including depreciation) are to be expressed on the basis of the disclosure year (ie, the year ended 30 June). 2. Although the IM refers to the remaining depreciation being spread over the regulatory period, which could be read literally to mean it should be spread over the 4 years ended 31 March 2015, the practical interpretation consistent with the MAR wash up provisions in the IPP is to spread the remaining depreciation over the 4 disclosure years ending 30 June 2015. 3. As noted, the only amount referenced to the 31 March year is the regulated revenue (ie, the application of the forecast MAR to Transpower's pricing). 4. The treatment Transpower proposes agrees with our understanding of the application of the IPP and IMs to the MAR wash-up.
<p>Pass through and recoverable costs for forecast MAR update 12/9/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. Under paragraph (e) of the definition of MAR in the IPP, the pass through costs and recoverable costs are excluded from the MAR wash up calculation cost building blocks in Schedule E of the IPP. 2. Under the definitions in the IPP of HVAC revenue and HVDC revenue for the purposes of the MAR wash up calculation in Schedule E, the amounts recovered from customers for these cost elements in the relevant pricing year are excluded from the MAR wash up. 3. As a result, the pass through and recoverable costs and associated recovered revenues are excluded from the ex-post economic gain or loss for the disclosure year and do not result in an EV account entry. 4. Compliance with the price path is demonstrated under the IPP if the forecast

	<p>revenues (excluding any amounts passed to customers through pricing for pass through costs and recoverable costs) do not exceed the forecast MAR.</p> <ol style="list-style-type: none"> 5. The IMs define the allowable pass through costs and recoverable costs, but do not set the timing rules for recognition. Therefore we would expect that the normal GAAP rules for accrual of costs and treatment of over or under accruals would apply such that any difference will get washed up in the pricing for a subsequent pricing year. 6. It is up to Transpower to reconcile the forecast amounts and the actual amounts recovered in its pricing and to maintain the necessary records. Transpower is free to forecast updated amounts, provided the constituent parts meet the definitions in the IMs. 7. Provided there is a clear reconciliation of the EV account balances, there should be no issue with combining the EV account and any unrecovered/over-recovered pass through and recoverable costs in an overall reflection of amounts owed to or recoverable from customers through its pricing. 8. The definitions of pass through costs and recoverable costs do not include any allowance for the WACC rate to be applied to any over or under-accrual amounts carried forward from year to year (unlike the EV account balances). On this basis, they should be carried forward at their dollar amounts.
<p>Revenue from disposed assets 12/9/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. It is expected that the proceeds of assets disposed of (including scrap and other asset items) would be treated as regulated revenue or alternately as an offset to the write off of the assets. 2. For disclosure purposes we accept the treatment of these amounts as revenue rather than as an offset against depreciation.
<p>Tax Adjustments and deductible opex 12/9/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. In our Guide on calculating the MAR wash-up (Appendix 2, Section I(2)) we gave guidance that in calculating the regulatory profit/loss before tax you should use 'values that are consistent with values used in other MAR building blocks'. 2. As per our guidance on deductible expenditure (Appendix 2, Section I(3)), we accept that the Opex allowance can be used as the starting point for deductible expenditure (excluding the notional interest adjustment calculated separately), with adjustments for any material tax adjustments identified in the preparation of the tax provision for the 2013 statutory accounts (for example, tower painting). 3. We interpret the application of the 'tax rules' (IM clause 2.3.1(1)) to mean that tower painting does need to be adjusted for.
<p>Proceeds from asset sales 12/9/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. Although the asset valuation IM refers to assets being commissioned, we believe you need to take a practical view on what 'commissioned' means in the IMs. 2. If an asset can be commissioned and used in providing electricity transmission services while the balance of the project to which it relates is being completed, then it appears that the asset can be included in the RAB at that time. 3. However, if an asset can only be used in electricity transmission services when the whole project is completed, you could take the view that the asset only

	<p>enters the RAB when the project is 'commissioned'.</p> <p>4. The project-based treatment appears to defer the time at which depreciation would commence for some assets, which appears to us to be a conservative treatment.</p>
<p>EV Adjustments in revenue 12/9/2012</p>	<p>Necessary Modification:</p> <ol style="list-style-type: none"> 1. We agree that an adjustment is required to avoid double counting of the ex-post economic gain or loss in Transpower's revenue setting. 2. Because the EV adjustment in the forecast MAR does not actually result in an EV account entry, our preference is not to adjust the actual revenues in the Schedule E MAR wash up calculation. 3. Our preferred approach is to instead make an adjustment to ensure that the portion of the EV account balance calculated under clause 5.3(3)(a) of the IPP and that is taken forward to pricing in a later year under clause 5.3(4)(b) does not include any EV adjustment that has already been taken to the calculation of revenues, so that the full ex-post economic gain or loss from Schedule E is applied to the EV account, but only the net amount after deducting the EV adjustment is taken forward to the later forecast MAR. 4. Our understanding is that this approach would progressively reduce the EV account balances and that only incremental portions of the ex-post economic gain or loss each year would be carried forward to the forecast MAR update.
<p>Base (minor) capex forecast approach 28/9/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. Transpower must provide an explanation of any material variation between the Minor capex proposal originally submitted by Transpower for the 2012/13 forecast MAR and the actual Minor capex amounts commissioned, based on the capex categories used in Transpower's capex proposal. 2. We require an overall explanation of the total capex outturn against the capex allowance of \$301.9 million set out in clause 5.4(3)(d)(ii) of the IPP determination. This is intended to be a high level explanation only, and does not need to be at the same level of detail as the review by capex category. Any explanation should take into account the fact that the Minor capex allowance is fungible between the years of RCP1, so if there has been a material shift in timing of commissioned Minor capex between the 2012/13 year and later years, this should be explained.
<p>Amendments to Commissioning dates in the forecast MAR 10/7/2012</p>	<p>Clarification:</p> <ol style="list-style-type: none"> 1. Transpower can optionally update the forecast MAR if the commissioning date for an asset under a major capex project slips out. 2. The IPP Reasons Paper (at para 3.8.10) states that: "The updates will also reflect any changes to commissioning timing assumptions for Major capital expenditure approvals already incorporated in the forecast MAR." 3. Clause 3.3(2) requires the Commission to "...determine any appropriate updates to each forecast MAR". We consider this adjustment to timing for major capex to be an appropriate adjustment, but not a mandatory one in all cases; the 2013 s53ZD notice sets out the mandatory adjustments that Transpower must make in calculating the updates to the forecast MARs. The notice requires that the adjustment to the timing assumption in the forecast MAR must be made where the 'commissioning date assumption' (as defined in the Capex IM determination) in respect of the last asset in the project is amended and approved by the Commission.

	<ol style="list-style-type: none"><li data-bbox="512 181 1436 383">4. The notice does not preclude Transpower from also adjusting the forecast commissioning timing for major capital expenditure where the 'commissioning date assumption' for the project as a whole has not been amended and approved. The only adjustment it does specifically preclude on the timing of capex is: "No adjustments are to be made in the update of the forecast MAR for changes in the timing assumptions for minor capital expenditure."<li data-bbox="512 405 1436 613">5. If Transpower opts not to adjust for the forecast timing of major capex, the previous forecast MAR will apply, adjusted only for the mandatory adjustments outlined in the notice. Transpower may then choose to set its revenue for pricing purposes at a level that is lower each year than the approved forecast MAR (see clause 3.4(1) of the IPP Determination: "...do not, in aggregate, exceed the forecast MAR.>").
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