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Commerce Commission
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Proposed amendments relating to insurance entitlements, other compensatory entitlements, and other regulated income: Draft decision

1. Transpower welcomes the opportunity to respond to the Commerce Commission's (the Commission) draft decision on the treatment of insurance entitlements (published 3 September 2024) .
2. We outline below the draft decision and Transpower's current approach and in the appendix step through each aspect to assess its workability and desirability.
3. We support the intent of the Commission's decision, for both Transpower and the Electricity Distribution Businesses, however we consider that the Commission's proposals for Transpower are not required as we have a transparent and workable arrangement in place. The Commission's proposed solution is administratively difficult and does not work well with the Transmission Pricing Methodology (TPM).
4. The Commission's draft decision is:
   - 4.1. In the case of capex insurance entitlements relating to damaged or destroyed assets:
     - 4.1.1. Where there is a replacement asset, offset the amount from the cost of the replacement asset that is to be added to the Regulatory Asset Base (RAB).
     - 4.1.2. Where there is no replacement asset, treat the amount as other regulated income (ORI).
   - 4.2. In the case of opex insurance entitlements, offset the amount against reported operating expenditure for the year, with any entitlement exceeding the corresponding spend be treated as ORI.
   - 4.3. In the case of compensatory entitlements, no change to Transpower's Input Methodologies.
5. Transpower's current treatment for all insurance entitlements is to treat these amounts as ORI, after adjusting for the 'retention factor'[1] relating to the adverse incentive outcome because of the incremental expenditure responding to the insurance event. This is

[1] Equal to 1 minus the calculated incentive rate, being ~24% in RCP3.

consistent with our previous communications with the Commission on this in August 2023.

6. We consider the proposal by the Commission has a high, and complex, administrative burden and would potentially lead to perverse outcomes in the TPM as it stands. Appendix A compares the Commission’s draft decision against our current treatment.
7. We do not consider that the Commission’s proposed changes are required to ensure that Transpower insurance entitlements are appropriately allocated.

Yours sincerely

Joel Cook
Head of Regulation

Attachment 1: Comparison of treatment options

	Transpower's current treatment	Draft decision
Compatibility with the TPM	High compatibility. Write-offs of existing assets are recovered through the residual charge. Other regulated income is also recovered through the residual charge. Any replacement asset is recognised as part of any benefit-based investment (BBI) or connection asset. The beneficiaries or customers therefore fund only the replacement asset and the effect of any write-off and other regulated income is recovered through the residual charge.	Low compatibility. Write-offs of existing assets are recovered through the residual charge. Any replacement asset is recognised as part of any BBI or connection asset. Note, for connection assets the allocation of the connection charge is based on a notional value, so a reduction in specific connection assets, and therefore a reduction in the revenue recovered via capital charges, would be spread across all connectees. Where a BBI replacement asset is offset by any insurance entitlement, the beneficiaries would only fund the difference under the TPM. Where the insurance proceeds entirely offset the replacement asset value, the beneficiaries do not incur any charge in relation to the asset. This does not appear to be a desirable outcome.
Compatibility with expenditure incentives	High compatibility. The Commission has demonstrated the equalisation of incentives, and an adjustment to other regulated income for this ensures an appropriate net incentive return. Any expenditure incurred above the insurance entitlement is borne by the regulated supplier, however this is driven by its own insurance decisions.	Low compatibility. Only compatible where any insurance entitlement is offset against operating expenditure. Not compatible where any insurance entitlement is offset against the value of commissioned assets. This is because Transpower is incentivised for capex on an as incurred basis, and the Commission has not proposed amendments to Transpower's Capex Input Methodologies to account for this.

	Transpower's current treatment	Draft decision
Consistency with GAAP	More consistent. Insurance entitlements are reported as other income under GAAP. For regulatory purposes, insurance entitlements are reported as other regulated income. Note there is a difference between the two equal to the retention rate.	Less consistent. Insurance entitlements are reported as other income under GAAP. For regulatory purposes, the treatment of insurance entitlements would depend on the level of entitlement and its relationship with any incremental expenditure.
Effect on cashflows	Slightly less desirable. The cashflows related to the insurance entitlement are added to Transpower's EV account and recovered over five years in the following period. Additionally, for significant events, any cashflow impact is further mitigated by the catastrophic event reopener available to Transpower.	More desirable. The cashflows related to the insurance entitlement are returned to customers over the life of the replacement asset or at the same time as the operating expenditure is recovered.
Administrative burden	Low. Other regulated income need only be adjusted by the retention rate.	High. Insurance entitlements must be allocated to incremental expenditure. Insurance entitlements offsetting any replacement asset must be recorded in the fixed asset register and depreciated in a manner consistent with the underlying asset. For GAAP, insurance entitlements are often initially recognised as an accrual. Any adjustments to the accrual and on settlement will require adjustments to the carrying

	Transpower's current treatment	Draft decision
		value of any recognised 'negative asset' in the RAB, creating further complexity.
Compatibility with RAB indexation	High compatibility. The RAB value of the underlying asset remains consistent with GAAP, reducing the risk of error or misstatement.	Low compatibility. The RAB value of the underlying asset becomes untethered from GAAP, increasing the risk of error or misstatement.