

Memo

To: Jeremy Cain, Transpower New Zealand

From: Stephen Gray, Dinesh Kumareswaran

Date: 25 October 2016

Subject: Corrections to Frontier Economics memo

1 Our memo entitled *Issues arising from Commerce Commission WACC Workshop* (4 October 2016) commented on, amongst other matters, analysis set out by Dr Lally in an appendix (the Lally appendix) to one of his reports to the Commission.¹

2 Since writing that memo, we have discovered the following inconsequential errors which, for completeness, we bring to your attention:

- a. At paragraph 11a of our original memo, we noted that the Lally appendix finds that the rate on the day approach results in a NPV=0 violation amounting to -0.04% of the initial value of the new investment. In fact, the Lally appendix finds that the rate on the day approach results in a NPV=0 violation amounting to **-0.4%** of the initial value of the new investment.
- b. As a result of this error, we reported at paragraph 13a of our original memo that the value of the NPV=0 violation under the rate on the day approach, in respect of new investment forecast by Transpower, would be \$30,000. If the error above is corrected, the value of the NPV=0 violation would be approximately **\$300,000**. Whilst this figure is larger than the figure reported in our original memo, it is still negligibly small, particularly when compared to Transpower's forecast RAB over RCP2.
- c. At paragraph 11b of our original memo, we noted that the Lally appendix finds that the trailing average approach results in a NPV=0 violation amounting to -0.19% of the initial value of the new investment. In fact, the Lally appendix finds that the trailing average approach results in a NPV=0 violation amounting to **-1.9%** of the initial value of the new investment. Our estimate of the value of the NPV=0 violation under the trailing average approach, in respect of Transpower's forecast expenditure, was reported correctly at paragraph 13b as \$1.4 million.

¹ Lally, M., 2016, *Review of further WACC issues*, 22 May.

d. In Table 1, we reported incorrectly that the Transpower's forecast capex as a proportion of RAB, averaged over RCP2, is 0.9%. The correct figure is in fact **1.5%**, which is still very small. This figure was reported correctly at paragraph 3b of our original memo.

3 Correction of the errors above do not alter any of the conclusions we reached in our original memo.