COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

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Reconsideration of Transpower's individual price-quality path determination in response to the Electricity Authority decisions on Transmission Pricing Methodology

Changes to 2021-22 expenditure allowances for the costs of TPM development and implementation

Final decision

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Chapter 1 – Introduction

1. This paper sets out our decision on how we are treating Transpower's costs for the period 1 July 2021 to 30 June 2022 (**DY22**) for developing and implementing a new transmission pricing methodology, which will determine ultimately how much of those costs can be passed on to consumers.

The Electricity Authority requested we reconsider Transpower's IPP

2. In 2020, the Electricity Authority (the **Authority**) requested that the Commerce Commission (the **Commission**) reconsider the *Transpower Individual Price-Quality Path Determination 2020* [2019] NZCC 19 (**Transpower IPP**) under section 54V(5) of the Commerce Act (the **Act**).[1] The Authority made this request at the same time as notifying us that it had issued guidelines (**2020 TPM guidelines**) that were likely to be relevant to the exercise of our powers or performance of our duties or functions under Part 4 of the Act.

3. The 2020 TPM guidelines and accompanying reasons paper set out requirements for a proposed new Transmission Pricing Methodology (**TPM**) together with the Authority's decision on process and timeframe for development and implementation of the TPM. The process and timeframe included Transpower submitting a proposed TPM meeting the guidelines requirements by 31 June 2021 followed by a Code review phase which, in turn, would be followed by a number of implementation phases leading to the publication of new prices to commence 1 April 2023. The timeline assumed some overlap in the commencement of the different phases.

4. The Authority's notification advised that it required Transpower to develop a new TPM. The Authority further advised us that it considered there would be increased costs to Transpower to develop and, if the Authority were to decide to include it in the Code, implement a new TPM.[2] The Authority considered these costs were likely to be more than *de minimis*.

5. In October 2021, we reconsidered the Transpower IPP and concluded that it would be desirable to amend the Transpower IPP to take account of Transpower's expenditure to develop and implement the new TPM in more than one stage.[3] A key consideration for the timing and number of reopeners would be the extent to which appropriate levels of confidence in Transpower's TPM expenditure became available. We determined to amend the IPP at that time to account for costs incurred by Transpower in development of the TPM for the 2020-21 disclosure year.

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[1] Electricity Authority to Chief Executive of the Commerce Commission, *Development of a proposed new transmission pricing methodology*, 10 June 2020, para 5.

[2] Electricity Authority to Chief Executive of the Commerce Commission, *Development of a proposed new transmission pricing methodology*, 10 June 2020, paras 4 and 5.

[3] Commerce Commission, *Reconsideration of Transpower's individual price-quality path determination in response to the Electricity Authority decision on Transmission Pricing Methodology guidelines – changes to 2020-21 expenditure allowances for the costs of TPM development – Final reasons*, 7 October 2021, para 9.

6. In April 2022, the Authority notified the Commission that it had incorporated the new TPM into the Electricity Industry Participation Code 2010 (the **Code**), that Transpower was required to implement the new TPM with a commencement date of 1 April 2023, and that this was likely to be relevant to our powers or functions under Part 4 of the Act.[4] The Authority advised that this Code change will result in increased costs to Transpower,[5] and requested that we consider amending the Transpower IPP determination under section 54V(5).[6]

7. We consider that the Authority's two notifications and reopener requests together encompass the whole of Transpower's costs in relation to development and implementation of the TPM incorporated into the Code in April 2022, commencing from the Authority's issue of the 2020 TPM guidelines.

We have decided to reconsider and amend Transpower's IPP

8. Our decision is to reconsider and amend Transpower's IPP to allow Transpower to recover its actual expenditure on developing and implementing the new TPM for DY22. We have made amendments to Transpower's IPP to give effect to the recovery of costs incurred in relation to developing and implementing the new TPM.

Structure of this reasons paper

9. In Chapter 2 (Background and basis for our changes) we set out:

   9.1 the statutory framework for reconsidering and amending Transpower's IPP determination following the Authority's advice of its decisions on the 2020 TPM guidelines and the incorporation of the new TPM into the Code; and

   9.2 the background to our decision, including our October 2021 consideration of the first stage of Transpower's costs to develop and implement the TPM.

10. In Chapter 3 (Our assessment of Transpower's TPM expenditure and our amendments to Transpower's IPP determination) we set out:

   10.1 the information Transpower provided us in support of our reconsideration of Transpower's IPP for DY22;

   10.2 our consultation process and summary of the submission received on our draft decision;

   10.3 our final decision; and

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4 Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022, para 3.

5 Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022, para 3.

6 Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022, para 5.

10.4 our reasons for amending the Transpower IPP determination to allow Transpower to recover its actual expenditure on the development and implementation of the new TPM for DY22.

Chapter 2 – Background and basis for our changes

11. This chapter sets out:

    11.1 the statutory framework for reconsidering and amending Transpower's IPP determination following the Authority's advice of its decisions on the 2020 TPM guidelines and the incorporation of the new TPM into the Code; and

    11.2 the background to our decision, including our October 2021 consideration of the first stage of Transpower's costs to develop and implement the TPM.

Statutory framework for reconsidering and amending the Transpower IPP determination following the Authority's advice of its decisions and reconsideration requests

12. We are required to determine Transpower's individual price-quality path under Part 4 of the Act. An individual price-quality path is determined on an *ex-ante* basis and applies for a regulatory period of 5 years,[7] although we may set a shorter period than 5 years if we consider doing so would better meet the purpose of Part 4 under section 52A of the Act.[8]

13. We set out Transpower's individual price-quality path in a determination we make under section 52P of the Act. Once determined, Transpower's individual price-quality path may not be reconsidered or reopened within a regulatory period except in limited circumstances. One of those circumstances is where the Authority has asked us to reconsider a section 52P determination under section 54V(5) of the Act. Under section 52V(2) of the Act, the Authority may ask us to reconsider a section 52P determination where it makes a provision of the Code, or a decision under the Code, that is likely to be relevant to the Commission's functions. Section 54V(4) requires us to take these matters into account when reconsidering a section 52P determination.

14. The Authority has made two such requests that are relevant to Transpower's individual price quality path determination for the regulatory period from 1 April 2020.[9] Upon receipt of such a request, section 54V(5) requires that the Commission must reconsider and, "to the extent that the Commission considers it necessary or desirable to do so", amend the individual price-quality path determination to take account of the relevant matters. Matters identified by the Authority at the time of making its requests were its decisions under, and in relation to, the Code relating to the pricing methodology applicable to Transpower and the impact of those decisions on Transpower's costs over the regulatory period.

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7 Commerce Act 1986, section 53ZC(2)(a) and 53M(4).

8 Commerce Act 1986, section 53ZC(2)(a) and 53M(5).

9 Electricity Authority to Chief Executive of the Commerce Commission, *Development of a proposed new transmission pricing methodology*, 10 June 2020; Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022, para 3.

15. As part of any section 52P reconsideration required under section 54V we consider that we have discretion to take a staged approach to amending the relevant determination where we consider this to be necessary and desirable to best give effect to the section 52A purpose.

16. Under Section 52Q of the Act if we propose amending a section 52P determination in a material way we may only do so after we have consulted with interested parties. On 11 October 2022, we published our draft decision and sought submissions from interested parties.[10]

Background to the IPP determination

17. On 29 August 2019, we published a paper that set out our decisions and supporting reasons for setting Transpower's individual price-quality path for the five-year regulatory period from 1 April 2020 (**Reasons paper**).[11] Transpower's individual price-quality path, which we determine under Part 4 of the Act, sets the maximum revenues that Transpower may recover from its customers for its electricity transmission services, as well as the minimum quality standards it must meet for those services, for each year of the regulatory period.

18. On 14 November 2019, we determined the Transpower IPP determination under section 52P of the Act, which sets out Transpower's individual price-quality path for the regulatory period from 1 April 2020 to 31 March 2025. This is Transpower's third individual price-quality path, and the regulatory period is referred to as "RCP3".[12]

Our decisions on operating expenditure and capital expenditure allowances for TPM development

19. In the IPP Reasons paper we noted:[13]

> X44 Our expenditure decisions do not include any opex allowance or approved base capex for further development of the TPM because the development, timing and amount of expenditure necessary to make that development happen is still not sufficiently certain. The Electricity Authority has published a consultation paper on the TPM,[41] and it appears likely that Transpower will need to respond to finalisation of updated TPM guidelines at some time during RCP3 by making changes to the TPM.[42] An adjustment to the expenditure allowances may be required during the regulatory period to accommodate this at the request of the Electricity Authority, which is permitted under the Act.[43]
>
> [footnotes omitted]

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[10] Commerce Commission, *Reconsideration of Transpower's individual price-quality path determination in response to the Electricity Authority decisions on Transmission Pricing Methodology – Changes to 2021-22 expenditure allowances for the costs of TPM development and implementation – Draft decision*, 11 October 2022, paras 8-12 and 15-20.

[11] Commerce Commission, *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019

[12] Commerce Commission, *Transpower Individual Price-Quality Path Determination 2020* [2019] NZCC 19.

[13] Commerce Commission, *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, at X44.

Our RCP3 decision on the wash-up calculation

20. In the IPP Reasons paper, we explained our decision for Transpower's forecast maximum allowable revenue (MAR) to be calculated using a building blocks approach with a MAR wash-up.[14] The wash-up would correct for any over or under recovery of revenue by Transpower.[15]

21. This wash-up mechanism is implemented in the Transpower IPP determination in the following way:

    21.1 clause 9 requires Transpower to annually calculate a wash-up in accordance with clause 29;

    21.2 clause 29 sets out the various inputs that Transpower must use in calculating the wash-up. Clause 29.1.1 requires Transpower to use the approach and formulae specified in Schedule E; and

    21.3 Schedule E sets out each 'building block' of the wash-up calculation.

22. Formula H of Schedule E specifies the 'Transmission revenues received' wash-up building block of the wash-up calculation. This building block is defined as being the 'actual transmission revenue'. Similarly, formula K of Schedule E specifies that 'other regulated income' is a wash-up building block of the wash-up calculation.

23. Clause 7 of the Transpower IPP determination currently defines "actual transmission revenue" to mean:

> the revenue received by Transpower in a pricing year for electricity transmission services;

24. Clause 7 of the Transpower IPP determination currently defines "other regulated income" to mean:

> income associated with the supply of electricity transmission services, excluding actual transmission revenue and investment-related income;

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14 Commerce Commission, *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, at X45.2.

15 Commerce Commission, *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, at X45.5.

Our 2021 decision to amend Transpower's IPP determination in stages to reflect Transpower's TPM development expenditure

25. In 2020, we received a request from the Authority to reconsider the Transpower IPP determination under section 54V(5).[16] We considered which amendments to that determination were necessary or desirable to take account of advice from the Authority of its decision on 2020 TPM guidelines.[17]

26. Our view in that decision was that under section 54V(5) of the Act, it was desirable to amend the Transpower IPP determination to take account of Transpower's expenditure in developing and implementing the new TPM in stages. This was because, at the time of decision, we only had sufficient certainty and clarity to make amendments to the Transpower IPP determination that related to Transpower's TPM development expenditure for DY21.

27. Accordingly, we decided that the Transpower IPP determination would be amended in stages. We noted in 2021 that it would be desirable to set an *ex-ante* adjustment in any subsequent stages if Transpower was able to provide us with sufficient information to give us confidence that its forecast expenditure was credible. This would provide Transpower with an incentive to complete the development of the TPM efficiently.

28. We stated in our 2021 reasons paper that if we proposed further amendments for later years in RCP3, we intended to consult with interested parties on those amendments.

Our 2021 decisions

29. Our 2021 decision allowed Transpower to recover its actual DY21 opex, by amending Transpower's IPP determination to:

    29.1 increase the 'opex allowance' provided for in clause 29.1.6(a) of the Transpower IPP determination for the purposes of the wash-up building blocks calculation from $271.5 million to $276.5 million; and

    29.2 increase the 'forecast opex' provided for in clause 33.2.1 of the Transpower IPP determination for the purposes of the IRIS calculation from $281.2 million to $286.2 million.

30. We did not increase the 'standard incentive rate base capex allowance' in clause 31.2.5 and Schedule C4 (columns 5 and 7) of the Transpower IPP determination for the purposes of the base capex expenditure adjustment, as none of the incurred expenditure advised to us by Transpower for 2020-21 was capex.

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16 Electricity Authority, *Letter to Commerce Commission – Development of a proposed new transmission proposed new transmission pricing methodology (TPM)*, 10 June 2020

17 Commerce Commission, *Reconsideration of Transpower's individual price quality path determination in response to the Electricity Authority decision on Transmission Pricing Methodology guidelines – changes to 2020-21 expenditure allowances for the costs of TPM development*, 7 October 2021

31. In practice, these amendments allow Transpower to recover its actual DY21 opex in the RCP4 price path (ie, in the next regulatory period), with an appropriate adjustment for the time value of money.

Chapter 3 – Our assessment of Transpower's TPM expenditure and our amendments to Transpower's IPP determination

32. This chapter sets out:

    32.1 the information Transpower provided us in support of our reconsideration of Transpower's IPP for DY22;

    32.2 our consultation process and summary of submission received;

    32.3 our decision; and

    32.4 our reasons for amending the Transpower IPP determination allowing Transpower to recover its actual expenditure on the development and implementation of the new TPM for DY22.

Summary of our decision

33. Our decision is to amend Transpower's IPP determination to:

    33.1 allow Transpower to recover its actual expenditure on the development and implementation of the TPM in DY22, through the wash-up building blocks calculation;[18] and

    33.2 increase the pool of fungible operating expenditure by the amount of Transpower's actual expenditure on the development and implementation of the TPM in DY22, in the incremental rolling incentive scheme (IRIS) incentive calculation.

34. Our decision includes both TPM development expenditure incurred by Transpower, which was referenced in the Authority's June 2020 request,[19] and TPM implementation expenditure incurred by Transpower, as referenced in the Authority's April 2022 request.[20]

35. Transpower has advised that its forecast expenditure for implementing the new TPM in the remaining years of RCP3 is still highly uncertain for a number of reasons. On this basis, we do not consider there is yet sufficient certainty or clarity on Transpower's costs going forward to make an *ex-ante* provision for future costs and that staged re-openers continue to be appropriate. We anticipate one or more further reopeners are likely to be necessary for DY23 onwards.

Information provided by Transpower for its 2022 application

36. In its letter dated 10 June 2022, Transpower provided us with information to enable us to evaluate the expenditure that it has incurred in DY22 on the development and implementation of the new TPM.[21] Transpower's development costs arise as a consequence of the 2020 TPM Guidelines, which required Transpower to develop and submit a proposal for the transmission pricing methodology to the Authority.[22] In April 2022, the Authority confirmed its decision to adopt the TPM by amending the Code. This decision gives rise to Transpower's costs of implementing the Transmission Pricing System (**TPS**).

37. Transpower provided indicative expenditure figures and a breakdown of costs by category supporting its application. Transpower indicated in its letter that it would provide us with its final DY22 TPM related expenditure.[23]

38. Transpower also provided us with internal audit reports, carried out by Deloitte, for its TPM project. These reports provide a preliminary assessment on the expenditure on the TPM project.

39. The internal audit reports covered aspects of the TPM project including governance, risk and issue management, cost control and assurance practices, costs and expenditure.

40. Deloitte noted that:[24]

> the TPM actual expenditure appears reasonable and consistent with Transpower's obligation to develop the TPM, investigate systems, and administer the TPM to produce indicative pricing. Transpower has underspent relative to the original FY22 budget and is retaining a reasonable level of contingency to deal with unexpected costs for the remaining two months of FY22.

41. The reports reviewing Transpower's proposed expenditure (focusing more on Transpower's TPS costs forecasting) noted that:[25,26]

> The approach for forecasting the Technology Costs for FY22 is robust and follows an industry standard approach. The main risk comes from an incomplete set of user stories and/or under-estimating the effort required to deliver the defined user stories.

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21 Transpower New Zealand Limited to Transpower and Gas Manager of the Commerce Commission, *Transmission Pricing Methodology (TPM) – Disclosure Year 2021/22 Funding Arrangements*, 10 June 2022.

22 Electricity Authority, *Letter to Commerce Commission – Development of a proposed new transmission proposed new transmission pricing methodology (TPM)*, 10 June 2020.

23 We subsequently received final figures from Transpower on 11 July 2022. This is set out in para 43 in the current decision.

24 Ibid.

25 Transpower New Zealand Limited to Transpower and Gas Manager of the Commerce Commission, *Transmission Pricing Methodology (TPM) – Disclosure Year 2021/22 Funding Arrangements*, 10 June 2022.

26 Financial Year (FY) used in the Deloitte report runs for the same time period as a Disclosure Year (1 July to 30 June)

42. In these reports, Deloitte noted that the only Financial Year with a high level of confidence for forecasted costs was DY22. Forecasts for DY23-25 all had low confidence levels at this time.

43. Deloitte also noted that the TPM project had retained its cohesive project structure and effective governance model and that the TPM actual expenditure appears reasonable and consistent with Transpower's obligation to develop the TPM.

44. In a subsequent email, Transpower confirmed its final actual expenditure figures incurred in DY22.[27] Its total confirmed figures are:[28]

    44.1 $4.4 million for opex for the TPM programme;

    44.2 $71.4 thousand for the opex for TPS Investigation; and

    44.3 $2.0 million for capex for TPS Development.

45. To date, Transpower has not been able to provide robust expenditure forecasts for the remainder of RCP3. An independent audit report prepared by Deloitte has also stated that there is low confidence in the forecasts for DY23-DY25 of RCP3.

Our review of Transpower information provided in support of the Authority's request to reconsider the Transpower IPP determination

46. Transpower provided us with its actual capex and opex in DY22 incurred for developing and implementing the new TPM.

47. For DY22, we consider it is appropriate to allow Transpower to fully recover its actual costs, because:

    47.1 Transpower is required to develop and implement a TPM, the costs of which are not already provided for in the Transpower IPP determination for RCP3;

    47.2 under its relevant statutory objective and purpose,[29] the Authority has concluded that there will be substantial net benefits to electricity consumers over the long term from implementing the new TPM;[30]

    47.3 while it is not possible to provide incentives for efficient expenditure in respect of costs that have already been incurred, we consider that, given

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27 Email from Joel Cook (Head of Regulation of Transpower) to Matthew Clark (Transpower and Gas Manager of the Commerce Commission) regarding final expenditure numbers for the TPM project for DY22 (11 July 2022).

28 Email from Joel Cook (Head of Regulation of Transpower) to Matthew Clark (Transpower and Gas Manager of the Commerce Commission) regarding final expenditure numbers for the TPM project for DY22 (11 July 2022).

29 Sections 15 and 32(1) of the Electricity Industry Act.

30 Electricity Authority, *Transmission pricing methodology 2020 Guidelines and process for development of a proposed TPM, Decision*, 10 June 2020, page i.

the relatively low materiality of the expenditure,[31] Deloitte's independent TPM project review gives us sufficient confidence to approve Transpower's actual opex for inclusion in the opex allowance for the price path and the 'forecast opex' amount for the IRIS incentive and capex for inclusion in the incremental approved listed project base capex and "standard incentive rate base capex allowance"; and

47.4 approving the actual amount, while Transpower is in the process of obtaining forecasts with higher levels of confidence, should give Transpower sufficient certainty to continue with investment for its TPM implementation, which is consistent with section 52A(1)(a) of the Act.[32]

48. For future stages of this reopener, we consider it would be desirable to consult on amending Transpower's IPP determination on an *ex-ante* basis where we have sufficient confidence in the forecasts. Doing so would be consistent with s 52A(1)(b) of the Act,[33] as it would provide incentives for Transpower to complete its TPM implementation efficiently. We have received indications from Transpower that it may be in a position to provide forecasts with higher levels of confidence in early 2023.

49. Once Transpower has provided more accurate forecasts of its TPM implementation expenditure for the later years of RCP3, we will consider what further amendments to the Transpower IPP determination are necessary or desirable to take account of Transpower's costs to implement the new TPM, consistent with the guidelines and Code amendments made by the Authority.[34] If further amendments are proposed, we intend to consult further with interested parties on our proposed decisions at that time.

Our consultation process

50. We published our draft decision on 11 October 2022.[35] In our draft decision, we proposed to amend Transpower's IPP determination to allow Transpower to recover its actual expenditure on the development and implementation of the TPM in DY22 (Stage Two). In our draft decision we invited stakeholders to submit on our proposed approach by 25 October 2022.

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[31] Stage Two proposed amendments are of relatively low materiality, with the future revenue impact being substantially lower than the 1% revenue threshold typically used as a benchmark in price path reconsideration.

[32] Section 52A(1)(a) of the Act is that suppliers of regulated services "have incentives to innovate and invest, including in replacement, upgraded, and new assets".

[33] Section 52A(1)(b) of the Act includes that suppliers of regulated services "have incentives to improve efficiency …".

[35] Commerce Commission, *Reconsideration of Transpower's individual price-quality path determination in response to the Electricity Authority decisions on Transmission Pricing Methodology – Changes to 2021-22 expenditure allowances for the costs of TPM development and implementation – Draft decision*, 11 October 2022

Summary of submission received

51. We received one submission through our consultation process. Powerco submitted in support of our draft decision to allow Transpower to recover its TPM development and implementation costs.[36] It submitted in support of the principle that costs incurred by regulated suppliers as a result of regulatory change must be recoverable.

52. Powerco also submitted that an efficient process for confirming the forecast costs is warranted. It stated:[37]

> For forecast costs, a pragmatic approach to dealing with the range of costs is warranted. For example, the Transpower forecast TPM implementation costs for FY22 – 25 could be included in opex and capex allowances at least at the lower level of the forecast ranges.
>
> […]
>
> In this case, where Transpower is implementing an Electricity Authority decision, an efficient outcome should minimise the effort to confirm final allowances. This could involve Commerce Commission and Transpower addressing the mechanics and the outcome being published. As an overarching principle, administrative processes for changes to allowances should be proportionate to the costs and risks involved to consumers.

53. We acknowledge Powerco's submission on process but note that this is outside the scope of this decision. We note that we are currently considering in-period adjustments and reopeners of price-quality paths in the 2023 IM Review.[38] We may also consult on our processes for reconsidering Transpower's IPP, within the requirements under the Commerce Act when we receive future applications.

Our decision

54. On the basis of the information provided by Transpower, and having considered the submission on our draft decision, our decision is to allow Transpower to recover its actual TPM development and implementation expenditure for DY22 by amending the Transpower IPP determination.

55. The Transpower Individual Price-Quality Path Amendment Determination 2022 (No.1) will give effect to these decisions.[39]

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36 Powerco Limited, *Feedback on draft decision: Transpower IPP changes for costs of TPM*, 25 October 2022.

37 Ibid.

38 Further information is available on our website: https://comcom.govt.nz/regulated-industries/input-methodologies/input-methodologies-for-electricity-gas-and-airports/input-methodologies-projects/2023-input-methodologies-review; In particular, see Commerce Commission *Part 4 Input Methodologies Review 2023: Process and Issues Paper* (20 May 2022) at Chapter 7, available at https://comcom.govt.nz/__data/assets/pdf_file/0031/283864/Part-4-Input-Methodologies-Review-2023-Process-and-Issues-paper-20-May-2022.pdf.

39 The Amendment Determination can be found at: https://comcom.govt.nz/regulated-industries/electricity-lines/electricity-transmission/transpowers-price-quality-path/setting-transpowers-price-quality-path-from-2020.

Our decision is to increase Transpower's DY22 'opex allowance' for the purposes of the wash-up building blocks calculation

56. Our decision is to increase Transpower's opex allowance that applies to Transpower's price path for DY22 by $4.5 million. This increases the total opex allowance under clause 29.1.6(b) of the Transpower IPP determination for DY22 from $276.0 million to $280.5 million.

57. The opex allowances that were set for each disclosure year of RCP3 in the Transpower IPP determination in November 2019 are for fungible annual pools of opex. The increase for the TPM development and implementation opex is additional to the original DY22 amount set out in the Transpower IPP determination.

58. If we did not increase the pooled opex allowance for DY22, the current revenue and expenditure wash-up mechanism in Schedule E of the Transpower IPP determination would treat any expenditure on the TPM as an overspend of opex. This would not allow Transpower to record its TPM opex as a wash-up entry in its EV account, nor to recover the amount as future revenue.

59. The opex allowance for DY22 for TPM development and implementation for the purposes of the price path is calculated on a comparable basis to the amount of $276.0 million opex allowance provided for in clause 29.1.6(b) of the Transpower IPP determination. This calculation basis excludes operating lease payments capitalised in accordance with the *Transpower Input Methodologies Determination 2010* [2012] NZCC 17, as amended and consolidated as at 29 January 2020 (Transpower IMs).

60. The effect of making the change to the $276.0 million forecast opex amount is that the updated opex allowance will be used in the wash-up building blocks calculation under clause 29 and Schedule E of the Transpower IPP determination for DY22.

61. This will allow Transpower to recover the expenditure in the RCP4 price path (Transpower's next individual price-quality path that will apply for the regulatory period after RCP3). This mechanism is described in our 2019 Reasons paper.[40]

Our decision is to increase Transpower's DY22 'forecast opex' for the purposes of the IRIS calculation

62. Our decision is to increase the opex allowance that applies to Transpower's IRIS incentive for DY22 by $4.5 million. This increases the total 'forecast opex' amount under clause 33.2.2 of the Transpower IPP determination for DY22 from $285.9 million to $290.4 million.[41]

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40 *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, Attachment J, paragraph J2.2.3.

41 Difference in values of opex allowance for the purpose of the wash-up building blocks and forecast opex for the purpose of calculating opex incentive amount can be explained by the way the Transpower IPP treats operating lease payments. Under clause 29.1.6, the opex allowance calculation **excludes** operating lease payments capitalised in accordance with the Transpower IM. Contrast this to clause 33.2, where the forecast opex **includes** operating lease payments otherwise capitalised in accordance with the

63. The opex allowances that were set for each disclosure year of RCP3 in the Transpower IPP determination in November 2019 for the IRIS are for fungible annual pools of expenditure. The increase allowed for the TPM development and implementation opex in this decision is additional to the original DY22 amount.

64. In view of the low materiality of the amount involved, we do not consider the additional complexity of dealing with any expenditure variance separately from the general pool of opex is warranted, so we have increased the overall pool of approved expenditure for the IRIS instead.

65. If we did not make an increase to pooled forecast opex for DY22, the IRIS incentive mechanism would treat the extra expenditure on the TPM as an overspend of opex and Transpower would treat that amount as a negative incentive entry in its EV account.

66. The 'forecast opex' for DY22 for TPM development and implementation for the purposes of the IRIS has been calculated on a comparable basis to the amount of $285.9 million 'forecast opex' provided for in clause 33.2.2 of the IPP determination.

Our decision is to increase Transpower's DY22 'standard incentive rate base capex allowance' for the purposes of the base capex expenditure adjustment

67. Our decision is to increase the base capex allowance that applies to Transpower's base capex expenditure adjustment incentive for DY22 by $2.0 million. This changes the incremental approved listed project base capex determined in 2022 from N/A to $2.0 million and increases the approved standard incentive rate base capex allowance from $277.3 million to $279.3 million in Schedule C4 of the Transpower IPP determination.

68. The base capex allowances that were set for each disclosure year in the Transpower IPP determination in November 2019 for this capex incentive in accordance with the *Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination)* [2012] NZCC 2, as amended and consolidated as at 29 January 2020 are for fungible pools of capital expenditure.[42]

69. Any forecast capital expenditure for TPM development and implementation for inclusion in the 'standard incentive rate base capex allowance' must be calculated on a comparable basis to the amount of $277.3 million specified by clause 31.2.5 and Schedule C4 (columns 2 and 7) of the Transpower IPP determination, which excludes operating lease payments capitalised in accordance with the Transpower IMs (ie, as

Transpower IM. This will result in a slightly higher amount for the forecast opex. We received confirmation from Transpower that the actual opex for DY22 did not include any operating lease payments so we are increasing opex allowance and forecast opex by the same amount.

42 *Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination)* [2012] NZCC 2, as amended and consolidated as at 29 January 2020, Schedule B1, term *d.*

for the IRIS opex allowance, the base capex allowance must be calculated on an expenditure basis rather than a commissioned basis).[43]

70. Transpower has confirmed that DY22 actual capex for the TPM development and implementation does not include any amounts that would be treated for financial reporting purposes as capitalised operating leases. This means the capex is all included in the updated standard incentive rate base capex allowance.

71. Transpower's actual expenditure for TPM development and implementation for DY22 includes capex related to the TPS required to calculate pricing under the TPM. Actual capex expenditure for DY22 was $2.0 million, therefore an adjustment is required to the incremental approved listed project base capex under column 5 of Schedule C4 and the standard incentive rate base capex allowance under column 7 of Schedule C4 as above.

[43] See Schedules C2 and C4 of the Transpower IPP determination for a comparison of the expenditure basis versus the commissioned basis treatments of capex.