

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

Date of publication: 7 October 2021

Introduction

1. This paper sets out our decisions on how to treat Transpower’s costs for implementing new transmission pricing. Our decisions are informed by submissions from the consultation we undertook on the draft decision, and they will determine ultimately how much of the costs can be passed on to consumers.
2. Our decisions are given effect to through an amendment determination under section 52Q of the Commerce Act 1986 (Act), which amends the *Transpower Individual Price-Quality Path Determination 2020* [2019] NZCC 19 (Transpower IPP determination).¹ We have made amendments to the Transpower IPP determination:
 - 2.1 to take account of Transpower’s expenditure to develop and implement a new Transmission Pricing Methodology (TPM), consistent with new guidelines issued by the Electricity Authority (Authority); and
 - 2.2 to correct for drafting errors in the definitions of ‘actual transmission revenue’ and ‘other regulated income’, to ensure the wash-up calculation required under clause 9 of the Transpower IPP determination can be calculated correctly.
3. We have made the first of these amendments after having reconsidered the Transpower IPP determination under section 54V(5) of the Act. Section 54V(5) requires us, if asked by the Authority, to reconsider the Transpower IPP determination and, to the extent that we consider it necessary or desirable to do so, amend that determination to take account of one of the matters listed in section 54V(4) of the Act.
4. One of those listed matters in the Act is if we receive advice from the Authority under section 54V(2)(c) that it has issued guidelines that are likely to be relevant to the exercise of our powers or performance of our duties or functions under Part 4 of the Act.
5. We received advice from the Authority under section 54V(2)(c) of the Act that it issued new guidelines in respect of the TPM that are likely to be relevant to our powers or functions under Part 4 of the Act.² The Authority requested us under section 54V(5) of the Act to reconsider the Transpower IPP determination.³

¹ A copy of the Transpower IPP determination is available via the Commission’s website here: https://comcom.govt.nz/_data/assets/pdf_file/0034/188782/Transpower-Individual-Price-Quality-Path-Determination-2019-2020-NZCC-19-14-November-2019.PDF.

² Electricity Authority to Chief Executive of the Commerce Commission, *Development of a proposed new transmission pricing methodology (TPM)*, 10 June 2020, para 3.

³ Electricity Authority to Chief Executive of the Commerce Commission, *Development of a proposed new transmission pricing methodology (TPM)*, 10 June 2020, para 5.

6. Under sections 54V(5) and 54V(2)(c), we must, if asked by the Authority, reconsider a section 52P determination (eg, the Transpower IPP determination) and, to the extent that we consider it necessary or desirable to do so, amend the determination to take account of the guidelines advised to us by the Authority.
7. Transpower submitted its TPM proposal to the Authority on the due date of 30 June 2021.⁴
8. In addition to the proposed amendments to reflect Transpower's TPM development expenditure, we are also correcting drafting errors in the definitions of 'actual transmission revenue' and 'other regulated income', which are currently in clause 7 of the Transpower IPP determination. We have corrected these drafting errors to ensure the wash-up calculation required under clause 9 of the Transpower IPP determination can be calculated correctly.
9. We have decided to amend the Transpower IPP determination in stages to take account of Transpower's expenditure to develop and implement the new TPM, consistent with the new guidelines issued by the Authority. We consider under section 54V(5) of the Act that it is desirable to make the amendments in stages to ensure we can have sufficient confidence in the accuracy of the TPM development expenditure forecasts for each year of the RCP3 regulatory period before we make any amendments to the Transpower IPP determination that reflects that forecast expenditure.
10. Our decisions for the first stage of proposed amendments to the Transpower IPP determination are:
 - 10.1 to allow Transpower to recover its actual expenditure on the development of the TPM in the disclosure year from 1 July 2020 to 30 June 2021 in the wash-up building blocks calculation;⁵ and
 - 10.2 to increase the pool of fungible operating expenditure by the amount of the actual expenditure on the development of the TPM in the disclosure year from 1 July 2020 to 30 June 2021 in the IRIS incentive calculation.

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

11. In accordance with the Authority's request, we have reconsidered the Transpower IPP determination under section 54V(5) and considered which amendments to that determination are necessary or desirable to take account of advice from the Authority of its decision on new TPM guidelines.

⁴ Electricity Authority, *Transpower submits proposed TPM to the Authority*: <https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/transmission-pricing-review/development/transpower-submits-proposed-tpm-to-the-authority/>.

⁵ For the purposes of the wash-up building blocks calculation, the actual expenditure incurred by Transpower will be rounded to the nearest \$0.1M, which is the rounding convention we have adopted in our Transpower IPP determination decisions.

12. Our view is that under section 54V(5) of the Act it is desirable to amend the Transpower IPP determination to take account of Transpower's expenditure to develop and implement the new TPM in more than one stage. This is because we consider we only have sufficient certainty and clarity at this time to make amendments to the Transpower IPP determination that apply to Transpower's TPM development expenditure for the 2020-21 disclosure year.
13. We do not have sufficient confidence in the accuracy of the TPM development expenditure forecasts that apply to the remaining disclosure years of RCP3 (disclosure years 2021-22, 2022-23, and 2023-24) to determine what amendments to the Transpower IPP determination in respect to those remaining disclosure years may be necessary or desirable. We intend to consult on and make amendments that apply to those later disclosure years in later stages when we have sufficient confidence in those numbers.
14. Accordingly, we will amend the Transpower IPP determination in stages:
 - 14.1 a first stage of proposed amendments that will cover Transpower's TPM development expenditure for the 2020-21 disclosure year, which covers the period up until when Transpower has submitted its TPM proposal to the Authority (Stage One). Given the timing of these amendments for Stage One, there is a high level of confidence in the figures for the 2020-21 disclosure year. The amendments are essentially being made on an *ex-post* (ie, after the event) basis; and
 - 14.2 a second stage of proposed amendments that will cover Transpower's TPM development expenditure for the remaining disclosure years of RCP3 (disclosure years 2021-22, 2022-23, and 2023-24), to be proposed when Transpower is able to produce accurate forecasts of its proposed TPM development expenditure for those later years, which we expect to be after the Authority approves the TPM (Stage Two). The Authority expects the TPM to be consulted on, approved and in operation for Transpower's pricing year commencing 1 April 2023.⁶
15. At the time of proposing Stage Two amendments, if we do not have sufficient confidence regarding the accuracy of Transpower's TPM development expenditure forecasts for remaining disclosure years of RCP3, we may decide to defer the amendments to later time. For example, if at Stage Two we only have sufficient confidence in the accuracy of the numbers for the 2021-22 and 2022-23 disclosure years, but not the final disclosure year of RCP3 (2023-24), we may decide it is desirable to wait until Transpower has been able to produce an accurate expenditure forecast for that final disclosure year before we make any amendments.

⁶ Electricity Authority, *Transpower submits proposed TPM to the Authority*: <https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/transmission-pricing-review/development/transpower-submits-proposed-tpm-to-the-authority/>.

16. We anticipate that in view of that later higher level of confidence around the numbers, Stage Two amendments (and later stages, if applicable) will happen on an *ex-ante* (ie, forward-looking) basis for the later years of RCP3 where practicable, and would only be calculated on an *ex-post* (ie, wash-up) basis where credible forecasted numbers are not then possible.
17. If Transpower is able at any stage to provide us with sufficient information to give us confidence that its forecast expenditure is accurate for Stage Two or any later stages, we consider that setting an *ex-ante* adjustment is desirable because it will provide Transpower with an incentive to complete the development of the TPM efficiently.
18. If we propose further amendments for the later years, we intend to consult with interested parties on those Stage Two (and later, if applicable) amendments at that time.
19. In its letter of 12 March 2021, Transpower forecasts-
 - 19.1 TPM development opex totalling \$6.6 million in the 2020-21 and 2021-22 disclosure years;
 - 19.2 TPM establishment opex totalling \$9.2 million in the 2021-22 to 2023-24 disclosure years;
 - 19.3 TPM systems opex totalling \$0.9 million in the 2020-21 to 2022-23 disclosure years; and
 - 19.4 TPM systems capex totalling \$10.7 million in the 2021-22 to 2023-24 disclosure years.

Our decisions on Stage One amendments

20. Stage One includes amendments to Transpower's expenditure allowances for the actual expenditure in the disclosure year from 1 July 2020 to 30 June 2021 to take account of expenditure by Transpower on the development of the TPM in that disclosure year of the RCP3 regulatory period.
21. Our decision is to allow Transpower to recover its actual Stage One opex expenditure, to be given effect by the following proposed amendments to the Transpower IPP determination:
 - 21.1 increasing 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
 - 21.2 increasing the 'forecast opex' provided for in clause 33.2.1 of the Transpower IPP determination for the purposes of the incremental rolling incentive scheme (IRIS) calculation from \$281.2 million to \$286.2 million.

22. We are not increasing the ‘standard incentive rate base capex allowance’ in clause 31.2.5 and Schedule C4 (columns 2 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 is capex.
23. In practice, these amendments will allow Transpower to recover its actual Stage One expenditure in the RCP4 price path (ie, in the next regulatory period), with an appropriate adjustment for the time value of money.

Our decision to correct a drafting error in the Transpower IPP determination to ensure the wash-up calculation is calculated correctly

24. In reviewing the Transpower IPP determination for the purposes of considering the Authority’s request under section 54V(5), we have identified an error in the drafting of the definitions of ‘actual transmission revenue’ and ‘other regulated income’ in clause 7 of the Transpower IPP determination. Actual transmission revenue and other regulated income are inputs into the wash-up calculation that Transpower must calculate each year.
25. The error we have identified is that both definitions are drafted in a way that means ‘actual transmission revenue’ and ‘other regulated income’ do not exclude revenue received by Transpower for electricity transmission services performed by Transpower as system operator, and revenue received by Transpower for new investment contracts. The effect of this is that the wash-up calculation will be calculated incorrectly, because it will include these additional revenues. This unintended effect is inconsistent with our policy decisions on Transpower’s individual price-quality path (see discussion at paragraph 32 below).
26. Our decision is to correct this drafting error under section 46 of the Legislation Act 2019. Under section 46, we can re-exercise a power to correct for minor errors in the original exercise of that power.
27. The power we have re-exercised is our section 52P power under the Act, which we originally exercised to make the determination which sets out Transpower’s individual price-quality path (ie, the Transpower IPP determination). The power has only been re-exercised for the purpose of correcting the error in the drafting of the definitions of ‘actual transmission revenue’ and ‘other regulated income’, which are currently in clause 7 of the Transpower IPP determination. No other change has been made to the Transpower IPP determination.⁷

⁷ As we are correcting a minor drafting error, we are not required to consult. However, as we consulted more broadly on amendments to the Transpower IPP determination to reflect Transpower’s TPM development expenditure, we consulted on this issue also.

Background and basis for our changes

Background to the IPP determination

28. 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).⁸ 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.
29. 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”.⁹

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

30. In the Reasons paper we noted:¹⁰

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

⁴¹ Electricity Authority “Transmission pricing review: 2019 issues paper” (23 July 2019).

⁴² The Electricity Authority’s indicative timeline assumes guidelines being published in April 2020 and Transpower having until 31 October 2021 to propose the new TPM (above n 41, at Figure 19). We discuss potential costs arising from the new TPM, including Transpower’s submission on a related IM amendment, at paragraphs I47 to I49.

⁸ *Transpower’s individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019

⁹ *Transpower Individual Price-Quality Path Determination 2020* [2019] NZCC 19.

¹⁰ *Transpower’s individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, at X44.

Our decision on the wash-up calculation

31. In the Reasons paper we noted that our decision was for Transpower’s forecast maximum allowable revenue (MAR) to be calculated using a building blocks approach with a MAR wash-up.¹¹ The wash-up would correct for any over or under recovery of revenue by Transpower.¹²
32. This wash-up mechanism is implemented in the Transpower IPP determination in the following way:
- 32.1 clause 9 requires Transpower to annually calculate a wash-up in accordance with clause 29;
- 32.2 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
- 32.3 Schedule E sets out each ‘building block’ of the wash-up calculation.
33. 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.
34. 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;
35. 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;
36. The policy objective of the wash-up is that the actual transmission revenues received by Transpower and the other regulated income received, as each are applied in the wash-up calculation, would not include Transpower’s system operator revenues or revenues associated with a new investment contract, consistent with the relevant policy decisions set out in the 2010 Transpower Input Methodologies Reasons Paper, which were given effect in the IPP determinations set prior to RCP3. When we set the IMs in 2010 we decided that it is appropriate to exclude Transpower’s system operator revenues and its revenues from new investment contracts from being subject to Transpower’s IPP.

¹¹ *Transpower’s individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, at X45.2.

¹² *Transpower’s individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, at X45.5.

37. The reasons for the exclusion of system operator revenues are explained in Chapters 3 and 4 of the 2010 IMs reasons paper.¹³ Briefly, the Commission's view was that where there is an agreement in respect of the provision of system operator services (such as the System Operator Service Provider Agreement (SOSPA) between the Electricity Authority and Transpower) it should not interpose itself between the parties by requiring the revenue associated with the agreement to be included in the IPP.
38. The reasons for the exclusion of new investment contract revenues are also explained in Chapters 3 and 4 of the 2010 IMs reasons paper.¹⁴ Briefly, the Commission concluded that it would not interpose itself between Transpower and its contract counterparties by requiring the revenue associated with new investment contracts to be subject to an IPP, provided certain conditions are met around workable competition.
39. We consider that the IPP determination for RCP3 should continue to be consistent with those policy decisions, which was our intention at the time we made that determination.

Information provided by Transpower

40. In its letter dated 12 March 2021, Transpower provided us with information to enable us to evaluate the expenditure that it has incurred to date on the TPM development.¹⁵ With that information it noted:

We note that the Commission has recorded that its expenditure decisions for RCP3 did not include any opex allowance or approved base capex associated with TPM changes required by the Authority.

41. Transpower further noted:

We continue to revise our forecast for TPM costs based on the latest information available. The forecast provided at the end of this letter is our current estimate of incremental costs above our baseline funding for RCP3...

We have increasingly less confidence of incremental opex and capex costs for each subsequent year of RCP3. Much depends on the Electricity Authority's response to our TPM proposal, particularly in relation to the approach the final new TPM takes to determining allocation of benefit-based charges. However, we are seeking a near term base opex and capex allowance determination This would provide us with sufficient certainty to secure the critical resource and establish the systems and processes needed to support the Authority, the wider industry and our obligation to implement and operate the new TPM once the Authority has approved it.

¹³ https://comcom.govt.nz/_data/assets/pdf_file/0026/63890/Transpower-Input-Methodologies-Reasons-Paper-Dec-2010.pdf, at paras 3.3.6 to 3.3.12 and 4.4.15 to 4.4.24.

¹⁴ https://comcom.govt.nz/_data/assets/pdf_file/0026/63890/Transpower-Input-Methodologies-Reasons-Paper-Dec-2010.pdf, at paras 3.3.13 to 3.3.16 and 4.4.4 to 4.4.14.

¹⁵ Transpower New Zealand Limited to General Manager Regulation of the Commerce Commission, *Transmission Pricing Methodology (TPM) – Funding Arrangements*, 12 March 2021

42. Transpower provided us with some indicative numbers, which indicate that there will be expenditure on the TPM development, establishment and systems out to 30 June 2024. This means there could be opex and capex requirements to be addressed in the Transpower IPP determination out as far as the 2023-24 disclosure year of RCP3.
43. In its 12 March 2021 letter, Transpower estimated a total TPM opex requirement of \$16.7 million and a total capex requirement of \$10.7 million over the 2020-21 to 2023-24 disclosure years.

Basis for the changes to the Transpower IPP determination

Statutory framework for reconsidering and amending the Transpower IPP determination following the Authority's advice of its decision on the new TPM guidelines

44. 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,¹⁶ though 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.¹⁷
45. We set out Transpower's individual price-quality path in a determination we make under section 52P of the Act (referred to as a section 52P determination). Once determined, Transpower's individual price-quality path may not be reconsidered (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, which states:
- (5) The Commission must, if asked by the Electricity Authority to do so, reconsider a section 52P determination and, to the extent that the Commission considers it necessary or desirable to do so, amend the determination, to take account of any matter referred to in subsection (4).
46. One of those matters listed in subsection (4) is:
- (c) any guidelines of which it [the Commission] receives advice under subsection (2)(c) that are likely to be relevant to the exercise of the powers or performance of the duties or functions of the Commission under this Part.
47. The "advice under subsection (2)(c)" referred to in subsection (4) is advice from the Authority that it has issued guidelines that are likely to be relevant to the powers or functions of the Commission under Part 4.¹⁸

¹⁶ Commerce Act 1986, section 53ZC(2)(a) and 53M(4).

¹⁷ Commerce Act 1986, section 53ZC(2)(a) and 53M(5).

¹⁸ Commerce Act 1986, section 54V(2)(c).

48. We received advice from the Authority under section 54V(2)(c) that it had issued new TPM guidelines that are likely to be relevant to our powers or functions under Part 4. The Authority also requested under section 54V(5) that we reconsider Transpower's 52P determination. We have done so, and decided to amend the Transpower IPP determination to the extent that we consider it necessary or desirable to take into account the advice from the Authority of its decision on its new TPM guidelines.
49. Under section 52Q(1) of the Act, we can only amend the Transpower IPP determination in a material way after we have consulted with interested parties, but we may make non-material amendments without prior consultation.

Statutory framework for correcting drafting errors in the Transpower IPP determination

50. Under section 46 of the Legislation Act 2019 we can re-exercise a power to correct for errors or omissions in the original exercise of that power. Section 46 states:

46 Power to do things may be exercised to correct errors

- (1) The power to do anything may be exercised to correct an error or omission in a previous exercise of the power.
- (2) Subsection (1) applies even though the power is not generally capable of being exercised more than once.

51. The types of errors amenable to correction under this power are limited, and the power is intended to only provide for minor error corrections.¹⁹
52. The relevant power we are proposing to re-exercise is our section 52P power. Section 52P(1) states:

52P Determinations by Commission under this section

- (1) The Commission must make determinations under this section specifying how the relevant forms of regulation apply to suppliers of regulated goods or services.

53. When the Commission makes a determination under section 52P it must publish a summary of the determination in the *Gazette* and make the whole determination publicly available.²⁰

¹⁹ The types of errors amendable to correction under this power has been canvassed in several cases in respect of section 13 of the Interpretation Act 1999, which is soon to be repealed as it has been replaced by section 46 of the Legislation Act 2019. See for example: *Ellipse Institute Limited v New Zealand Qualifications Authority* HC WN CIV-2012-404-3514 (16 August 2012); *Lopas v Commissioner of Inland Revenue* CA CA253/04 [30 November 2005]; and *Goulding v Chief Executive Ministry of Fisheries* [2004] 3 NZLR 173.

²⁰ Commerce Act, section 52P(7)(b) and (c).

Our consultation process

54. The Stage One 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.²¹
55. However, as described above, the Stage One actual expenditure at \$5.0 million is only the first tranche of the total TPM development, establishment and systems costs. While that Stage One expenditure is a relatively small amount, as noted above, Transpower has estimated that the total TPM costs will be approximately \$27.4 million for opex and capex combined.
56. In addition, we did not consider the changes would be ‘non-material’ changes for the purposes of section 52Q(1). They are a change to the Commission’s decision from November 2019 in terms of how much money Transpower will be allowed to recover, and therefore would be of interest to stakeholders and other interested parties. We consulted on our draft decisions accordingly.

Summary of submissions received

57. We published our draft decisions on 14 September 2021:
- 57.1 to amend the Transpower IPP determination in stages to take account of Transpower’s expenditure to develop and implement the new TPM, consistent with new guidelines issued by the Authority. We considered under section 54V(5) of the Act that it was desirable to make the amendments in stages to ensure we have sufficient confidence in the accuracy of the TPM development expenditure forecasts for each year of RCP3 before we make any amendments to the Transpower IPP determination that reflects that forecast expenditure;
- 57.2 in respect of the first stage of proposed amendments to the Transpower IPP determination, to specifically:
- 57.2.1 allow Transpower to recover its actual expenditure on the development of the TPM in the disclosure year from 1 July 2020 to 30 June 2021 in the wash-up building blocks calculation;
- 57.2.2 increase the pool of fungible operating expenditure by the amount of the actual expenditure on the development of the TPM in the disclosure year from 1 July 2020 to 30 June 2021 in the IRIS incentive calculation; and
- 57.3 to correct a drafting error in the Transpower IPP determination to ensure the wash-up calculation is calculated correctly.

²¹ See for example, *Commerce Act Transpower Input methodologies) Determination 2010* [2012] NZCC 17, clause 3.7.1c)(iv) in respect of the net cost of remediation in respect of a catastrophic event.

58. Our draft decisions were generally supported in submissions from Transpower,²² Trustpower,²³ Vector,²⁴ Powerco,²⁵ and Aurora.²⁶
59. Transpower agreed in all respects with our draft decisions. It noted the actual expenditure for the disclosure year from 1 July 2020 to 30 June 2021 is \$5.04 million, which under the number rounding convention we apply in the Transpower IPP determination is rounded to \$5.0 million in our final decision.
60. Transpower asked us to note that for the purposes of the CPI disparity adjustments required in the wash-up building blocks calculation and the IRIS in disclosure year 2021, there would be no disparity adjustments in respect of the incremental \$5.0 million adjustments in the disclosure year from 1 July 2020 to 30 June 2021. We agree with this approach and we note that for the purposes of clauses 29.2 and 33 of the Transpower IPP determination, no disparity adjustments will need to be applied to those portions of the 'opex allowance' and 'forecast opex' respectively.
61. Because this is a practical application of the existing wording of clauses 29.2 and 33 of the Transpower IPP determination, we do not consider that this requires any additional amendment to the determination.
62. Trustpower submitted that:
- In the circumstances we think the Commission should exercise its discretion to allow for the recovery of Transpower's prudent TPM development costs. Regulated suppliers should be able to recover prudent costs caused by another regulator's decision-making.
63. Trustpower supported our decision to take a staged approach to approving the TPM development expenditure.
64. Vector asked us to work with the Authority to ensure that distributor costs relating to participation in the process of TPM development driven by the Authority decisions on the TPM guidelines are taken into account in our decisions. However, this is outside of the scope of the Authority's request to us to reconsider the Transpower IPP determination.
65. The submissions are published on our website alongside this reasons paper.

²² Transpower New Zealand Limited – Our submission on the Commission's consultation on Transpower's cost recovery of the TPM development cost – 22 September 2021.

²³ Trustpower Limited – Transpower IPP TPM development expenditure allowances change consultation – 22 September 2021.

²⁴ Vector Limited – Reconsideration of Transpower's IPP in response to the EA's decision on TPM guidelines – 22 September 2021.

²⁵ Powerco Limited – Feedback on Transpower's IPP reconsideration for TPM development and drafting errors – 22 September 2021.

²⁶ Aurora Energy Limited – Transpower IPP TPM development expenditure allowance changes consultation – 22 September 2021.

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

66. As described above, in its letter of 12 March 2021, Transpower provided us with information in support of the Authority's request for us to reconsider the Transpower IPP determination. Transpower provided us with its forecast numbers (as at 12 March 2021) of what it estimated would be the incremental opex and capex costs of developing and implementing the new TPM above the amounts we determined in the Transpower IPP determination on 14 November 2019.
67. Transpower also engaged Deloitte to carry out an independent TPM project review, which provided us with confidence that costs of the TPM development will be incurred within an appropriate project rigour.
68. As indicated in Transpower's letter of 12 March 2021, it engaged KPMG to complete the first stage of the assessment of the impact of the TPM on Transpower's business. This assessment set out the scope and timing of resources required to enable Transpower to deliver the TPM. Transpower also engaged KPMG to carry out an assessment to derive and contrast comparability benchmarks for the expected TPM costs, but it reported that insufficient comparable information was available for the TPM development.
69. Transpower requested that we consider applying a specific wash-up mechanism to deal with the TPM development expenditure. However, in view of the relatively low materiality of the Stage One amounts, we do not consider that the complexity of a separate price path mechanism is justified. Our decision is not to accept Transpower's request for a new wash-up mechanism. We think it is just as effective in the circumstances to adjust the applicable expenditure allowances provided for in the Transpower IPP determination, including for the 2020-21 disclosure year in Stage One.
70. We would expect that Transpower's actual expenditure on the development of the TPM for the 2020-21 disclosure year would be equal to, or be very close to, the amount we are adjusting the expenditure allowance by and therefore no wash-up mechanism would be required.
71. For future stages, 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,²⁷ as it would provide incentives for Transpower to undertake later stages of its TPM implementation efficiently.
72. However, for Stage One, we consider it is desirable to allow Transpower to fully recover its actual costs, because:

²⁷ Section 52A(1)(b) of the Act includes that suppliers of regulated services "have incentives to improve efficiency ...".

- 72.1 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;
- 72.2 under its relevant statutory objective and purpose,²⁸ the Authority has concluded that there will be substantial net benefits to electricity consumers over the long term from implementing the new TPM,²⁹
- 72.3 while it is not possible to provide incentives for efficient expenditure in respect of costs that have already been incurred, we consider that, given the relatively low materiality of the Stage One expenditure, Deloitte's independent TPM project review gives us sufficient confidence to approve Transpower's actual Stage One opex for inclusion in the opex allowance for the price path and the 'forecast opex' amount for the IRIS incentive; and
- 72.4 approving the actual amount for Stage One, as well as indicating the likely process we would follow for considering later stages, should give Transpower sufficient certainty to continue with investment for its TPM implementation, which is consistent with section 52A(1)(a) of the Act.³⁰
73. Therefore, on the basis of the information provided by Transpower, and having considered submissions on our draft decision, our final decision is to apply Transpower's actual TPM development expenditure amount for the 2020-21 disclosure year and to allow Transpower to recover that amount by making adjustments for Stage One to the Transpower IPP determination.

²⁸ Sections 15 and 32(1) of the Electricity Industry Act.

²⁹ Electricity Authority, *Transmission pricing methodology 2020 Guidelines and process for development of a proposed TPM, Decision*, 10 June 2020, page i.

³⁰ 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".

Our amendments to Transpower's IPP determination

Stage One change #1: Increase the 2020-21 '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

Extent of reconsideration of the price path in the Transpower IPP determination

74. Our decision for Stage One is to increase Transpower's opex allowance that applies to Transpower's price path for the 2020-21 disclosure year by \$5.0 million. This increases the total opex allowance under clause 29.1.6(a) of the Transpower IPP determination for the 2020-21 disclosure year from \$271.5 million to \$276.5 million.
75. 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 operating expenditure. The Stage 1 increase for the TPM development opex is additional to the original 2020-21 amount.
76. If we had not made an increase to the pooled opex allowance for 2020-21, 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, and would not allow Transpower to record it as a wash-up entry in its EV account, nor recover the amount as future revenue.
77. The opex allowance for 2020-21 for TPM development for the purposes of the price path is calculated on a comparable basis to the amount of \$271.5 million opex allowance provided for in clause 29.1.6(a) 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).
78. However, Transpower has confirmed to us that its actual opex for TPM development for the 2020-21 disclosure year of \$5.0 million does not include any amounts that would be treated for financial reporting purposes as capitalised operating leases. This means the opex is all included in the updated opex allowance.
79. The effect of making the change to the original \$271.5 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 the 2020-21 disclosure year.

80. As Transpower's pricing for the 2020-21 pricing year was set based on the lower original opex allowance, the updated opex allowance will result in a wash-up variance amount that Transpower would enter into its EV account and be able to recover in future pricing years. Any wash-up variance amount would be added to the EV account in the way we contemplated when we set the smoothed RCP3 price path in November 2019, which would 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 is described in the 2019 Reasons paper.³¹

Stage One change #2: Increasing the 2020-21 'forecast opex' provided for in clause 33.2.1 of the IPP determination for the purposes of the IRIS calculation

Extent of reconsideration of the IRIS opex incentive in the IPP determination

81. Our decision is to increase the opex allowance that applies to Transpower's IRIS incentive for the 2020-21 disclosure year by \$5.0 million. This increases the total 'forecast opex' amount under clause 33.2.1 of the Transpower IPP determination for the 2020-21 disclosure year from \$281.2 million to \$286.2 million.
82. 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 first stage increase allowed for the TPM development opex is additional to the 2020-21 amount.
83. As for the price path amendment under Stage One proposed change #1, 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 decided to increase the overall pool of approved expenditure for the IRIS instead.
84. If we did not make an increase to pooled forecast opex for 2020-21, the current 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.
85. The proposed 'forecast opex' for 2020-21 for TPM development for the purposes of the IRIS has been calculated on a comparable basis to the amount of \$281.2 million 'forecast opex' provided for in clause 33.2.1 of the IPP determination.

³¹ *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper, 29 August 2019, Attachment J, paragraph J2.2.3.*

86. This basis of calculation includes operating lease payments otherwise capitalised in accordance with the Transpower IMs (ie, the IRIS opex allowance is essentially calculated on an expenditure basis rather than a commissioned assets basis).³² However, Transpower has confirmed to us that its 'forecast opex' for TPM development for the 2020-21 disclosure year of \$5.0 million does not include any amounts that would be treated for financial reporting purposes as capitalised operating leases and this means the 'forecast opex' is all included in the updated opex allowance for the IRIS.

Stage One - no increase to the 2020-21 'standard incentive rate base capex allowance' in clause 31.2.5 and Schedule C4 of the IPP determination for the purposes of the base capex expenditure adjustment

87. Our decision is to make no increase to the base capex allowance that applies to Transpower's base capex expenditure adjustment incentive for the 2020-21 disclosure year.
88. 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.³³
89. Any forecast capital expenditure for TPM development for inclusion in the 'standard incentive rate base capex allowance' must be calculated on a comparable basis to the amount of \$222.9 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 for the IRIS opex allowance, the base capex allowance must be calculated on an expenditure basis rather than a commissioned basis).³⁴
90. Transpower's actual expenditure for TPM development for the 2020-21 disclosure year of \$5.0 million does not include any amounts that are treated for financial reporting purposes and the Transpower IMs as capital expenditure. None of the expenditure for this disclosure year is capex, and therefore no adjustment is required to the base capex allowance for Stage One of our reconsideration of the Transpower IPP determination for the costs of TPM development.

Drafting changes to definitions of 'actual transmission revenue' and 'other regulated income' in the Transpower IPP determination

91. Under section 46(1) of the Legislation Act 2019, we have amended the definition of:

³² See Schedules C2 and C4 of the Transpower IPP determination for a comparison of the expenditure basis versus the commissioned basis treatments of capex as an example.

³³ *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*.

³⁴ See Schedules C2 and C4 of the Transpower IPP determination for a comparison of the expenditure basis versus the commissioned basis treatments of capex.

91.1 “actual transmission revenue”, which now reads:

means the revenue received by Transpower in a pricing year for electricity transmission services, excluding:

- (a) revenue received by Transpower for electricity transmission services performed by Transpower as system operator; and
- (b) revenue received by Transpower from new investment contracts;

91.2 “other regulated income”, which now reads:

means income received by Transpower, associated with the supply of electricity transmission services, excluding:

- (a) actual transmission revenue;
- (b) income associated with electricity transmission services performed by Transpower as system operator;
- (c) income associated with new investment contracts; and
- (d) investment-related income;

92. The difference between these definitions and the previous definitions in clause 7 of the Transpower IPP determination is that the new definitions expressly exclude revenue received by Transpower for electricity transmission services performed by Transpower as system operator, and revenue received by Transpower from new investment contracts.
93. In order to correct the drafting errors, we have re-published the section 52P Transpower IPP determination, which includes the correct definitions of “actual transmission revenue” and “other regulated income”. The re-published consolidated determination also incorporates the amendments following our final decisions on Transpower’s TPM development expenditure.