

Draft amendments to input methodologies for Transpower 2014 (No.2)

Draft reasons paper

Draft amendments proposed to be made under s 52X and s 52V(2) of the Commerce Act 1986 to the input methodologies for electricity lines services supplied by Transpower New Zealand Limited.

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Regulation Branch
Commerce Commission

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1. Introduction

Purpose of this paper

1. This paper seeks your views on proposed amendments to the input methodologies for electricity lines services supplied by Transpower New Zealand Limited (Transpower).
2. Submissions on the proposed draft methodology are due by 5pm, Friday 7 November 2014.

Determinations that would be affected by the draft amendments

3. We are consulting on proposed amendments to the following determinations:¹
 - 3.1 *Transpower Input Methodologies Determination* [2012] NZCC 17 (Transpower IM); and
 - 3.2 *Transpower Capital Expenditure Input Methodology Determination* [2012] NZCC 2 (Capex IM).
4. These amendments are intended to provide a mechanism for Transpower to apply for, and the Commission to approve, additional base capex for inclusion within the price path during the second regulatory period (RCP2)—1 April 2015 to 31 March 2020—in respect of five identified asset replacement and asset refurbishment projects (ie, ‘listed projects’).
5. We consider it is necessary to make these amendments prior to setting Transpower’s individual price-quality path in November 2014, so that a listed project mechanism can be reflected in the individual price-quality path for RCP2, which commences on 1 April 2015.

Overview of proposed amendments

6. We propose to amend the input methodologies for electricity lines services supplied by Transpower in the manner set out below:
 - 6.1 Amending the annual price path reconsideration provision in the Transpower IM to accommodate the revenue impact of approved base capex in respect of listed project assets that are forecast to be commissioned in RCP2.
 - 6.2 Inserting a definition of ‘listed project’ into the Capex IM.
 - 6.3 Inserting process requirements for application and approval of base capex in respect of listed projects in RCP2 into the Capex IM.

¹ Commerce Commission “Notice of intention: Proposed amendments to input methodologies for Transpower” (notice of intention, 10 February 2014); Commerce Commission “Process for further consultation on amendment to Transpower’s input methodologies for listed projects (email, 17 September 2014).

- 6.4 Amending the formula for calculating the annual 'base capex expenditure adjustment' in the Capex IM to maintain the incentive effects when additional base capex in respect of listed projects has been approved by the Commission.
7. The technical drafting of the proposed draft amendments is summarised in Chapter 5 and is described in detail in the attached *Draft Transpower Input Methodologies Amendments Determination 2014 (No.2)*.

Consultation background

8. As it currently stands, the Capex IM recognises capital expenditure incurred in relation to asset replacement and asset refurbishment projects as base capex, regardless of the dollar value of the projects. As such, even large (ie, projects with costs in excess of \$20 million) reconductoring projects fall within the base capex portfolio, for which the Commission must set a base capex allowance in advance of each regulatory period.
9. The base capex allowance is an approved pool of capital expenditure which permits substitution between projects and programmes within the overall base capex portfolio. Base capex is subject to an incentive framework which compares approved annual amounts of the base capex allowance with the actual values of commissioned assets funded as base capex.
10. In 2013, Transpower requested that the Commission extend the Capex IM definition of major capex to include expenditure on large reconductoring projects that would otherwise be included (in full or in part) within the base capex allowance.² Consistent with this request, Transpower's subsequent expenditure proposal for RCP2 did not include capital expenditure associated with five large reconductoring projects, proposing that they be excluded from base capex and submitted to the Commission for separate approval.³

² Email from Jeremy Cain (Chief Regulatory Advisor, Transpower) to Grant Weston, Jessica Bevin (Commerce Commission) requesting Capex IM amendment relating to large refurbishment and replacement projects (4 October 2013).

³ Transpower "Expenditure proposal regulatory control period 2" (December 2013) para 45.

11. On 10 February 2014, the Commission:
- 11.1 issued a notice of intention to begin work on proposed amendments to the input methodologies for Transpower;⁴ and
 - 11.2 released an issues paper which sought views on, amongst other things, whether Transpower's individual price-quality path should allow for resets of the forecast MAR during RCP2 to accommodate capital expenditure on replacement and refurbishment projects that have a high cost, broad scope and/or uncertain timing (ie, it contemplated inclusion of approved expenditure being included in resets of the forecast MAR during RCP2, even though it was excluded from the initial base capex allowance).⁵
12. In May 2014 we consulted on the process requirements for the application by Transpower and approval by the Commission of base capex in respect of listed projects as part of the individual price-quality path determination. This was followed in June 2014 with consultation on an amendment to Transpower's input methodologies that would allow it to recover revenues for certain listed projects under the individual price-quality path determination, through a reconsideration of the individual price-quality path. It was initially contemplated that we would reach a final decision on this reconsideration amendment as part of the wider group of amendments to Transpower's input methodologies published on 28 August 2014.
13. However, as set out in our August input methodologies and individual price-quality path reasons papers,⁶ we did not make a final decision on the reconsideration amendment at that time as our view on the most appropriate place to set out the approval mechanism for listed projects changed. Our earlier view was that the process requirements for the application by Transpower and approval by the Commission of base capex relating to listed projects should form part of the individual price-quality path determination. Our current view is that those process requirements should instead be set out in the Capex IM, as this is more consistent with s 54S of the Commerce Act.
14. Accordingly, we are publishing new draft amendments to:
- 14.1 the Capex IM, incorporating the listed projects base capex approval mechanism we have previously consulted on as part of the individual price-quality path determination;
 - 14.2 the Transpower IM, updating the reconsideration amendment to reflect where we now believe that the listed projects base capex approval mechanism should sit.

⁴ Commerce Commission "Notice of Intention: proposed amendments to input methodologies for Transpower" (10 February 2014).

⁵ Commerce Commission "Invitation to have your say on Transpower's individual price-quality path and proposal for the next regulatory control period" (issues paper, 10 February 2014), para3.25 and 3.26.

⁶ *Setting Transpower's individual price-quality path for 2015-2020* [2014] NZCC 23 (29 August 2014); Commerce Commission "Amendments to input methodologies for Transpower 2014" (reasons paper, 28 August 2014).

15. We are seeking views from interested parties before reaching a final decision on the input methodology amendments related to approval of base capex in respect of listed projects.
16. In making our final decision we will have regard to previous submissions on the listed projects base capex approval mechanism received in relation to the individual price-quality path and Transpower input methodology amendment consultation processes.
17. We made in-principle decisions on 29 August 2014 that Transpower's RCP2 individual price-quality path would include a mechanism to allow us to reconsider the forecast MAR to take account of approved base capex for five (large reconductoring) listed projects. We are therefore particularly interested at this point in submissions regarding how we implement that approval mechanism.

2. RCP2 listed project mechanism

Our decisions on the individual price-quality path for RCP2

18. On 29 August 2014 we confirmed we would use Transpower's existing individual price-quality path (ie, the one that applies from 1 April 2011 to 31 March 2015) as a starting point for the RCP2 individual price-quality path, with some enhancements.⁷
19. One of the RCP2 enhancements was that the individual price-quality path would include a mechanism to allow us to reconsider the forecast MAR during the course of RCP2 to take account of approved listed projects.⁸
20. Listed projects are base capex projects (or programmes), not major capex projects (or programmes).⁹ Therefore, approved base capex associated with listed projects is:
 - 20.1 subject to incentive mechanisms that apply to base capex;
 - 20.2 treated as part of the fungible pool of expenditure over which Transpower has discretion to prioritise; and
 - 20.3 as base capex relating to commissioned assets, is recognised in the regulatory asset base in the disclosure year of commissioning.
21. The base capex allowance determined in August 2014 excluded any base capex in respect of listed projects. The base capex allowance is used to set the initial determination of the forecast MAR for RCP2. Additional amounts of base capex for listed projects will be quantified during RCP2 as the RCP2 base capex of these projects is approved.¹⁰

⁷ *Setting Transpower's individual price-quality path for 2015-2020* [2014] NZCC 23 (29 August 2014), chapter 3.

⁸ *Setting Transpower's individual price-quality path for 2015-2020* [2014] NZCC 23 (29 August 2014) at Table 3.1. Reconsideration or amendment of grid output targets was not contemplated.

⁹ Commerce Commission, "Setting Transpower's individual price-quality path for 2015-2020" (reasons for draft decision, 16 May 2014) para C11-C13 and subsequently confirmed in *Setting Transpower's individual price-quality path for 2015-2020* [2014] NZCC 23 (29 August 2014) para 3.66 to 3.72.

¹⁰ *Setting Transpower's individual price-quality path for 2015-2020* [2014] NZCC 23 (29 August 2014) para X30, C76 and C77, and D12 to D14.

22. Five listed projects have been identified by Transpower and accepted by the Commission in advance of RCP2.¹¹ These are base capex projects or programmes:
- 22.1 that have an anticipated project cost of greater than \$20 million;
 - 22.2 that are reasonably required by Transpower, with at least one (or more) assets likely to be commissioned during RCP2;
 - 22.3 for which a commencement date within RCP2 cannot be forecast with specificity; and
 - 22.4 that are not already accommodated in the base capex allowance.¹²
23. The resulting listed projects for RCP2, and their indicative costs, from our decisions and reasons on how Transpower’s individual price-quality path will operate for RCP2, are outlined in Table 1.¹³

Table 1: Listed projects and indicative costs

Line for reconductoring (and section)	Indicative cost in RCP2 (\$m)	Indicative total project cost (\$m)
BPE-WIL A (WIL-JFD section)	49	49
OTB-HAY A (Churton Park section 45A-68)	28	28
CPK-WIL B (complete line)	26	26
BRK-SFD B (complete line)	11	65
BPE-WIL A (BPE-JFD section)	4	107
Total indicative costs	118	275

¹¹ The Commission did not accept Transpower’s submission that expenditure on implementing the Electricity Authority’s changes to transmission pricing should also be an additional candidate for treatment as a listed project. See *Setting Transpower’s individual price-quality path for 2015-2020* [2014] NZCC 23 (29 August 2014) at [D22] to [D27].

¹² There were five listed projects that met this corresponding proposed definition of “listed project” in Commerce Commission “Transpower individual price-quality path determination” (draft determination, 30 May 2014). The five listed projects were again confirmed in *Setting Transpower’s individual price-quality path for 2015-2020* [2014] NZCC 23 (29 August 2014) within Attachment D.

¹³ *Setting Transpower’s individual price-quality path for 2015-2020* [2014] NZCC 23 (29 August 2014) Attachment D, at Table D1.

24. If, after detailed technical studies, Transpower determines that the listed projects should include an enhancement component (ie, improve the original service potential of the assets), they may no longer meet the definition of ‘base capex’ projects / programmes. In that case, the existing provisions of the Capex IM would require Transpower to instead submit a major capex proposal in line with the other relevant provisions of the Capex IM.¹⁴

Features of the listed project mechanism

25. Features of the proposed listed project mechanism are set out below:
- 25.1 The mechanism applies for RCP2 only.¹⁵ We expect that Transpower will be in a position to comprehensively propose a base capex allowance for RCP3 that includes all forecast asset refurbishment and asset replacement projects from 2020/21 and beyond.
- 25.2 During RCP2 Transpower may submit an application to the Commission for approval of base capex in respect of a listed project.¹⁶ The requirements that must be met by Transpower, and the criteria the Commission will use to evaluate expenditure in respect of a listed project in RCP2, will be set out in the Capex IM.

¹⁴ *Setting Transpower’s individual price-quality path for 2015-2020* [2014] NZCC 23 (29 August 2014) at [D11] where it refers to the respective paragraphs (b) of the definitions of ‘asset refurbishment’ and ‘asset replacement’ in Capex IM, clause 1.1.5(2). These effectively exclude a project from the definition of ‘base capex’ and includes it in ‘major capex’ if the project improves the original service potential (for asset refurbishment) or materially improves the original service potential (for asset replacement).

¹⁵ Transpower has previously submitted that the estimation uncertainty associated with large reconductoring projects is not a transitional issue (ie, not isolated to RCP2). See, for example, Transpower “Response to IPP draft decision” (27 June 2014) at para 57. Submissions are invited on whether the listed project mechanism should apply beyond RCP2.

¹⁶ Implementation considerations mean that, in practice, any application would need to be received by the Commission by June 2018. This timing allows the Commission time to consider and potentially approve it before November 2018 (which is the last available opportunity to update the forecast MAR for RCP2).

- 25.3 The revenue impact of base capex in respect of listed projects will feed into Transpower's individual price-quality path in RCP2 through updates to the forecast MAR in a manner consistent with the Transpower IM reconsideration provisions for newly-approved major capex projects.¹⁷ The amendment to the price path will not take effect until the relevant pricing year relating to the disclosure year in which assets in respect of the project are forecast to be commissioned, and the update to the forecast MAR will only be available:
- 25.3.1 if Commission approval is given prior to November in a disclosure year, in the pricing year beginning the following April; or
 - 25.3.2 if Commission approval is given in or after November, in the relevant pricing year beginning after the disclosure year in which approval is given.¹⁸
- 25.4 The final date in RCP2 for submission of an application to the Commission for approval of base capex in respect of a listed project will be 30 June 2018. This lines up with the timing for the setting of prices for the final year of RCP2 and the required submission by Transpower in December 2018 on expenditure for RCP3.
- 25.5 Base capex in respect of listed projects will be subject to the base capex expenditure incentive framework in the Capex IM. Refer to chapter 3 for a description of the incentive processes and chapter 4 for demonstrations of the application of the annual base capex expenditure adjustment.

¹⁷ The revenue effect of the base capex approved in respect of a listed project will be used to update the forecast MAR for the years in which the assets to which the base capex relates are forecast to be commissioned. The Commission will amend the price path (ie, forecast MAR) to take account of the revenue impact of base capex in respect of the listed project. Later when the assets funded as base capex are actually commissioned, the MAR washup process in the individual price-quality path determination will replace the forecast base capex with the actual base capex, which may result in an ex-post economic gain or loss and a resulting EV account entry. That entry will result in an EV adjustment to the forecast MAR in a later year, so that over time Transpower's revenue will be based on the actual base capex value of the commissioned assets.

¹⁸ The term 'relevant pricing year' is defined in the individual price-quality path determination as meaning, in relation to a disclosure year, the pricing year commencing on 1 April immediately before the start of the disclosure year.

3. Processes, requirements and evaluation criteria for listed projects

26. In May 2014 we consulted on the requirements for the application by Transpower and approval by the Commission of base capex relating to listed projects as part of the individual price-quality path determination. Our current view is that, while those proposals remain appropriate in substance, they should instead be set out in the Capex IM as this is more consistent with s 54S of the Act.
27. This chapter outlines what processes, requirements and evaluation criteria for listed projects we consider should be set out in the input methodologies that apply to Transpower. It also outlines how base capex expenditure associated with listed projects will feed into the base capex expenditure incentive framework in the Capex IM.

Proposed timeframes and processes for evaluating applications for approval of base capex in respect of listed projects

28. Under the proposed listed project mechanism, Transpower may submit an application in relation to any one or more listed projects within RCP2 for approval of base capex in respect of that listed project.
29. The listed project mechanism will operate within some practical timing constraints relating to when Transpower calculates and announces its pricing for the pricing years in RCP2. Notably,
- 29.1 The base capex increment is only available:
- 29.1.1 if approval is given prior to November, in the pricing year beginning the following April; or
- 29.1.2 if approval is given in or after November, in the pricing year beginning after the disclosure year in which approval is given.
- 29.2 This timing reflects:
- 29.2.1 Transpower's *ex ante* price path compliance obligations within the individual price-quality path;
- 29.2.2 the timing of the Commission's reconsideration of Transpower's individual price-quality path, with reference to clause 3.7.4(5) of the Transpower IM and our decision to make any amendments to the individual price-quality path by the second Wednesday of November each year;
- 29.2.3 the need for any forecast base capex, where the listed project assets are forecast to be commissioned in the final year of the regulatory period, to be approved prior to November 2018; and

29.2.4 the timing of submission of an application to the Commission for approval of base capex in respect of a listed project for that final year, to be not later than 30 June 2018 to provide the time necessary for Commission approval by November 2018.

30. Also, Transpower's base capex proposal for RCP3 must be submitted to the Commission no later than the first working day of December 2018.¹⁹ It will encompass all forecast base capex, including in respect of the listed project assets, where the related assets are forecast to be commissioned in RCP3.
31. After receiving an application from Transpower, we will consider and evaluate it as soon as reasonably practicable.
32. If we decide to approve an amount of base capex for inclusion in Transpower's individual price-quality path, we will update the forecast MAR figures to provide for the revenue impact of the approved base capex in respect of the relevant listed project.

Proposed criteria the Commission will use to evaluate applications for approval of base capex in respect of listed projects

33. After receiving an application, we will consider and evaluate it in line with the consultation requirements and evaluation criteria in the Capex IM that apply to base capex.²⁰ We would then decide whether to approve an amount of base capex for inclusion in Transpower's individual price-quality, and what that amount might be.

Proposed requirements that must be met by Transpower

34. Prior to seeking approval of base capex in respect of any listed project, Transpower must meet a number of requirements, including requirements relating to:
 - 34.1 the extent of consultation and agreement with consumers; and
 - 34.2 the scope and specificity of information required from Transpower.
35. While the scope and specificity of information required from Transpower is comprehensive, it has the following purposes:
 - 35.1 Ensuring the Commission receives the information it requires to make a prompt turnaround decision;²¹

¹⁹ Capex IM, clause 2.2.1(3).

²⁰ The consultation requirements are specified in clauses 3.2.1 and 8.1.2 of the Capex IM. The evaluation criteria are specified in Schedule A of the Capex IM. In the event that the Commission does not comply with the timeframes for evaluating capital expenditure proposals, the provisions in Part 5 of the Capex IM apply.

²¹ Refer to the discussion in Chapter 4 on the importance of applications and approvals being made relative to the November dates for the annual updates of the forecast MAR.

- 35.2 Applying a consistent approach to that which would apply if the listed projects had been specified as part of the (December 2013) base capex proposal; and
- 35.3 Allowing the Commission to assure itself, in making its approval, that there is an appropriate commitment by Transpower to carry out the project, taking into account the potential expenditure flexibility for Transpower in increasing the overall base capex pool by the amount of additional base capex.

Extent of consultation and agreement with consumers

36. Before seeking approval of base capex in respect of any listed project, Transpower must, in line with clause 3.2.1(b) of the Capex IM, undertake consultation with interested persons. Consultation with interested persons should be of a scope commensurate with the project's nature, complexity, impact and significance.²²

Requirements that must be met by Transpower

37. Before seeking approval of base capex in respect of any listed project, Transpower must undertake a cost-benefit analysis commensurate to the project size and complexity. Currently this is (and will continue to be) a requirement for any base capex project costing more than \$20 million.²³
38. We consider that a cost-benefit analysis for a listed project that is consistent with determining expected net electricity market benefit is one that applies an expenditure objective such that the proposed base capex reflects the efficient costs that a prudent supplier of electricity transmission services would require to:
- 38.1 meet or manage the expected demand for electricity transmission services, at appropriate service standards, during the regulatory period and over the longer term; and
- 38.2 comply with applicable regulatory obligations associated with those services.
39. The cost-benefit analysis must include consideration of alternatives to the project, and for the project, where applicable. These alternative options could include non-replacement and demolition, enhancement or development of alternative assets, and non-transmission solutions.
40. Transpower must assess the current and future need for the applicable proposed assets by reference to the demand and generation scenarios in clause D4(1) of Schedule D of the Capex IM.²⁴

²² Capex IM, clause 8.1.2.

²³ See the Capex IM, clause 3.2.1. Transpower must undertake a cost-benefit analysis consistent with determining 'expected net electricity market benefit' (see also Schedule D of the Capex IM) and consult with interested persons.

²⁴ As defined in the Capex IM, clause D4(1).

41. Transpower must demonstrate that its Board of Directors has considered and approved (subject to Commission approval of an additional base capex amount) the business case for the listed project at least at the Transpower BC3 approval gate level. The Board must also show that it has delegated its authority to commence the listed project, subject only to our approval of the additional base capex. The business case considered and approved by Transpower's Board must include Transpower's fully completed quality assurance checklist.
42. Transpower must provide certification, by its chief executive officer, that:
 - 42.1 the information underpinning the application was derived from and accurately represents, in all material respects, the operations of Transpower; and
 - 42.2 the listed project to which the application relates was approved in line with the applicable requirements of Transpower's approval processes of directors and management.
43. In addition to the cost-benefit analysis, Transpower must, in its application for approval of base capex in respect of a listed project, provide us with:
 - 43.1 a description of the reasons for carrying out the listed project, supported by relevant technical information;
 - 43.2 the intended scope of the listed project, including specification of the grid outputs that apply in respect of the listed project;
 - 43.3 all relevant technical and costing information used to estimate both the cost of the listed project and alternative options, including details on risk allowances and contingencies; and
 - 43.4 the estimated cost of the listed project, broken down into year by year figures in 'expected disclosure year of commissioning' prices, and the assumptions used to derive the estimated cost.
44. Where we consider that, for the purpose of deciding whether to approve base capex in respect of a listed project we require further information from Transpower, we will request Transpower to provide such information by a date specified by us such that it is reasonable for Transpower to comply.

How base capex in respect of listed projects would feed into the expenditure incentive framework

45. The key components of the incentive framework for base capex are contained in Schedule B of the Capex IM. Revenue adjustments are given effect through the MAR washup process in Transpower's individual price-quality path determination.

Base capex incentive mechanisms

46. As noted earlier, approved base capex associated with listed projects is subject to incentive mechanisms that apply to base capex. The two incentive mechanisms that apply specifically to base capex are the:
- 46.1 base capex expenditure adjustment (Schedule B, clause B1 of the Capex IM)
 - 46.2 policies and processes adjustment (Schedule B, clause B2 of the Capex IM).

Base capex expenditure adjustment

47. As it currently exists, the base capex expenditure adjustment applies to the base capex allowance. For RCP2, this means the base capex allowance determined by the Commission on 29 August 2014.
48. The base capex allowance determined in August 2014 excluded any base capex in respect of the five listed projects. To ensure that the base capex expenditure adjustment also applies to approved RCP2 base capex associated with listed projects, some amendments to the mechanism are required. We propose amendments to the adjusted base capex allowance used in the annual base capex expenditure adjustment that would effectively combine the base capex allowance set in August 2014 with any further approved base capex in respect of a listed project.²⁵ That is, the base capex expenditure adjustment would measure Transpower's performance against all approved base capex (as approved in both the initial base capex allowance, plus the further base capex approved in respect of any listed project).
49. We also propose making an additional, non-material, amendment to the definition of 'base capex incentive rate' to correctly reference (within that definition) the base capex expenditure adjustment.²⁶
50. The disparity adjustments for the forecast CPI and the forecast FX rates in the annual base capex expenditure adjustment will work in the same way for approved base capex in respect of listed projects as it does for the base capex allowance. For consistency with the fungibility concept of base capex and to simplify any disparity

²⁵ The amendments we propose are to the definition of "adjusted base capex allowance" and to the calculation mechanism for the annual base capex expenditure adjustment.

²⁶ The current definition of 'base capex incentive rate' uses the term 'base capex incentive adjustment', whereas the correct defined term is 'base capex expenditure adjustment'. While this is a non-material amendment, we are including it within this consultation process for transparency and because it is a timely correction to part of the package of mechanisms that give effect to the base capex incentive framework.

adjustments for RCP2, we propose that the forecast CPI and forecast FX rates used for the base capex allowance in August 2014 would also be used for any proposed base capex in respect of a listed project. At the time we approve the base capex in respect of a listed project we will also determine the amount or percentage of that approved base capex to which the forecast FX rates will apply.²⁷

Policies and processes adjustment

51. No amendments to the existing policies and processes adjustment (Schedule B2 of the Capex IM) are necessary to accommodate approved base capex in respect of listed projects in this incentive mechanism. The applicable policies for base capex described in the December 2013 base capex expenditure proposal will apply to any base capex proposal made by Transpower for approval of base capex in respect of a listed project.
52. As the requirements that must be met by Transpower effectively include undertaking a cost-benefit analysis and consultation in accordance with clause 3.2.1 of the Capex IM, approval of base capex in respect of listed projects will mean that the value for 'h' in the policies and processes adjustment is zero. As for any other base capex, the value of 'h' (ie, compliance with clause 3.2.2 of the Capex IM, which relates to Transpower's compliance with its own policies and processes) is evaluated once the assets funded as base capex are commissioned.

²⁷ This is consistent with clause 2.2.1(2)(c) of the Capex IM and our base capex allowance decisions for RCP2 on 29 August 2014. See *Setting Transpower's individual price-quality path for 2015-2020* [2014] NZCC 23 (29 August 2014) at Attachment J, Table J1.

4. Illustrative scenarios on how the listed project mechanism would work

53. The following scenarios in this chapter demonstrate how we propose the listed project mechanism would work in RCP2 and the effect that approved base capex in respect of any of the listed projects would have on Transpower's forecast maximum allowable revenue:
- 53.1 Scenario 1: Application and approval in the first (2015/16) disclosure year, and prior to November 2015, of base capex where the listed project assets are forecast to be commissioned in the second to final disclosure years of RCP2 (ie, 2016/17 to 2019/20 disclosure years). This scenario illustrates how the mechanism will generally apply in the 2015/16 to 2017/18 disclosure years.
- 53.2 Scenario 2: Application and approval in the first (2015/16) disclosure year, but after November 2015, of base capex where the listed project assets are forecast to be commissioned in the third to final disclosure years of RCP2 (ie, 2017/18 to 2019/20 disclosure years). This scenario highlights differences from Scenario 1 as a result of base capex approvals falling in or after November in the 2015/16 to 2017/18 disclosure years.
- 53.3 Scenario 3: Application and approval in the fourth (2018/19) disclosure year, and prior to November 2018, of base capex where the listed project assets are forecast to be commissioned in the final disclosure year of RCP2 (ie, 2019/20 disclosure year), and in RCP3. This scenario illustrates the final time for base capex approvals under the listed project mechanism for RCP2 and shows the anticipated interface with the setting of revenues for RCP3.
- 53.4 Scenario 4: After completion of detailed technical studies, Transpower considers that the base capex relates to listed project assets that are forecast to be commissioned after RCP2 (ie, in RCP3).

Scenario 1: Application and approval of base capex in the first disclosure year, and prior to November 2015, in respect of listed project assets that are forecast to be commissioned in the second to final disclosure years of RCP2

54. This scenario illustrates how the listed project mechanism will generally apply in the 2015/16 (and 2016/17 and 2017/18) disclosure year.
55. Transpower applies for approval of base capex in respect of a listed project in the disclosure year 1 July 2015 – 30 June 2016 (ie, 2015/16 disclosure year), and in sufficient time for the Commission to consider and approve the base capex before November 2015.
56. The assets to which the base capex relates are forecast to be commissioned in one or more of the 2016/17 to 2019/20 disclosure years.
57. The scenario assumes that the Commission will approve the base capex in respect of the listed project prior to November 2015.

58. By the second Wednesday in November 2015 the Commission will update the forecast MAR under the individual price-quality path to take account of the revenue impact of the base capex in respect of the listed project (ie, update of forecast MAR) in the pricing years:

58.1 1 April 2016 to 31 March 2017 (2016/17 pricing year);

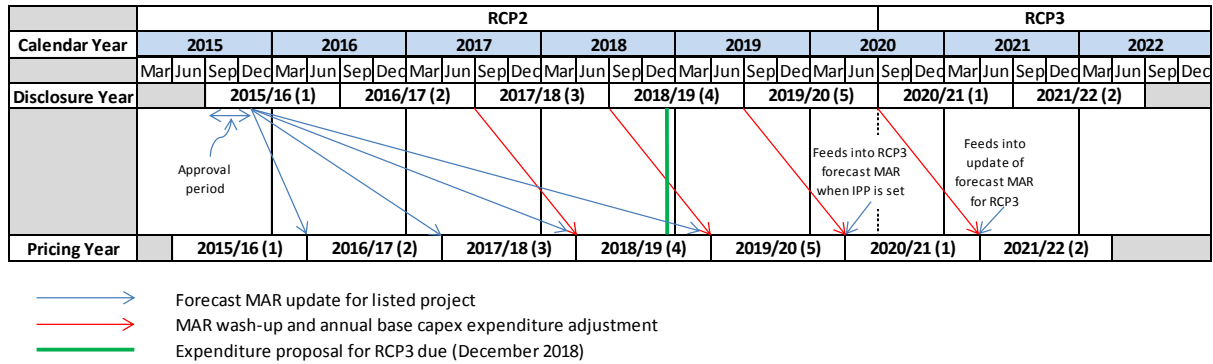
58.2 1 April 2017 to 31 March 2018;

58.3 1 April 2018 to 31 March 2019; and

58.4 1 April 2019 to 31 March 2020.

59. Those key timeline steps for this scenario are set out in Figure 1.

Figure 1: RCP2 timeline for scenario 1



60. At the conclusion of the 2016/17 disclosure year, the adjusted approved base capex for the purposes of determining the annual base capex expenditure adjustment under Schedule B1 of the Capex IM will be equal to:

60.1 the base capex allowance determined on 29 August 2014 for the 2016/17 disclosure year (\$249.5 million) (ie, term ‘d’); plus

60.2 the incremental base capex approved by the Commission with respect to the listed project for the 2016/17 disclosure year (ie, term ‘d’); plus

60.3 an adjustment correcting for the disparity between the forecast CPI and actual CPI in respect of both the base capex allowance and the approved base capex in respect of the listed project for the 2016/17 disclosure year (ie, term ‘e’); plus

60.4 an adjustment correcting for the disparity between the forecast FX rates and actual FX rates in respect of both the base capex allowance and the approved base capex in respect of the listed project for the 2016/17 disclosure year (ie, term ‘f’).

61. Any annual base capex expenditure adjustment that is calculated following the 2016/17 disclosure year will be taken into account in the forecast MAR update for the 2018/19 pricing year (fourth pricing year of RCP2).²⁸ The reason the adjustment is not carried into the forecast MAR in the 2017/18 pricing year is because the adjustment is calculated part way through that year (ie, in November 2017, which is in the pricing year 1 April 2017 to 31 March 2018 – the 2017/18 pricing year).
62. The MAR washup is calculated in accordance with the individual price-quality path determination. It takes into account the revenue effect of the actual base capex in respect of the listed project assets commissioned in the disclosure year, less the estimated revenue effect already taken into account in the amount of the forecast MAR. The result of the MAR washup calculation following the 2016/17 disclosure year will be taken into account in the forecast MAR update for the 2018/19 pricing year (fourth pricing year of RCP2).
63. At the conclusion of the 2017/18 disclosure year, the adjusted approved base capex for the purposes of determining the annual base capex expenditure adjustment under Schedule B1 of the Capex IM will be equal to:
 - 63.1 the base capex allowance determined on 29 August 2014 for the 2017/18 disclosure year (\$242 million); plus
 - 63.2 the incremental base capex approved by the Commission with respect to the listed project for the 2017/18 disclosure year; plus
 - 63.3 an adjustment correcting for the disparity between the forecast CPI and actual CPI in respect of both the base capex allowance and the approved base capex in respect of the listed project for the 2017/18 disclosure year; plus
 - 63.4 an adjustment correcting for the disparity between the forecast FX rates and actual FX rates in respect of both the base capex allowance and the approved base capex in respect of the listed project for the 2017/18 disclosure year.
64. Any annual base capex expenditure adjustment that is calculated following the 2017/18 disclosure year will be taken into account in the forecast MAR update for the 2019/20 pricing year (final pricing year of RCP2).
65. The result of the MAR washup calculation following the 2017/18 disclosure year will be taken into account in the forecast MAR update for the 2019/20 pricing year (final pricing year of RCP2).

²⁸ Under Schedule B1 of the Capex IM, the annual base capex expenditure adjustment for the disclosure year is generally the difference between the adjusted approved base capex described above and the actual base capex where the assets to which it relates are commissioned in the disclosure year, multiplied by the RCP2 base capex incentive rate of 33%.

66. At the conclusion of the 2019 disclosure year, the adjusted approved base capex for the purposes of determining the annual base capex expenditure adjustment under Schedule B1 of the Capex IM will be equal to:
- 66.1 the base capex allowance determined on 29 August 2014 for the 2018/19 disclosure year (\$231.6 million); plus
 - 66.2 the incremental base capex approved by the Commission with respect to the listed project for the 2018/19 disclosure year; plus
 - 66.3 an adjustment correcting for the disparity between the forecast CPI and actual CPI in respect of both the base capex allowance and the approved base capex in respect of the listed project for the 2018/19 disclosure year; plus
 - 66.4 an adjustment correcting for the disparity between the forecast FX rates and actual FX rates in respect of both the base capex allowance and the approved base capex in respect of the listed project for the 2018/19 disclosure year.
67. Any annual base capex expenditure adjustment that is calculated following the 2018/19 disclosure year will form part of the EV account balance at 30 June 2020 and, as is the case for adjustments that will flow through from RCP1 to RCP2, we anticipate will be taken into account in setting the amount of the forecast MAR for the 2020/21 pricing year (ie, when the forecast MAR for the individual price-quality path is set for the first pricing year of RCP3 in November 2019).²⁹
68. The result of the MAR washup calculation following the 2018/19 disclosure year would similarly form part of the EV account balance at 30 June 2020 and be taken into account in setting the amount of the forecast MAR for the 2020/21 pricing year.
69. At the conclusion of the 2019/20 disclosure year, the adjusted approved base capex for the purposes of determining the annual base capex expenditure adjustment under Schedule B1 of the Capex IM will be equal to:
- 69.1 the base capex allowance determined on 29 August 2014 for the 2019/20 disclosure year (\$213.1 million); plus
 - 69.2 the base capex approved by the Commission in respect of the listed project for the 2019/20 disclosure year; plus
 - 69.3 an adjustment correcting for the disparity between the forecast CPI and actual CPI in respect of both the base capex allowance and the approved base capex in respect of the listed project for the 2019/20 disclosure year; plus

²⁹ Any references in these illustrative scenarios to how the results of the annual base capex expenditure adjustment would be applied as EV adjustments in the forecast MAR for RCP3 assume that, subject to consultation, the individual price-quality path for RCP3 and the application of the EV adjustments in the forecast MAR would follow the same format as for RCP2. If after consultation at that time a different format of individual price-quality path is preferred for RCP3, we would anticipate that the individual price-quality path for RCP3 would include some form of mechanism that would carry over the revenue effects of RCP2 washups and incentive calculations to RCP3.

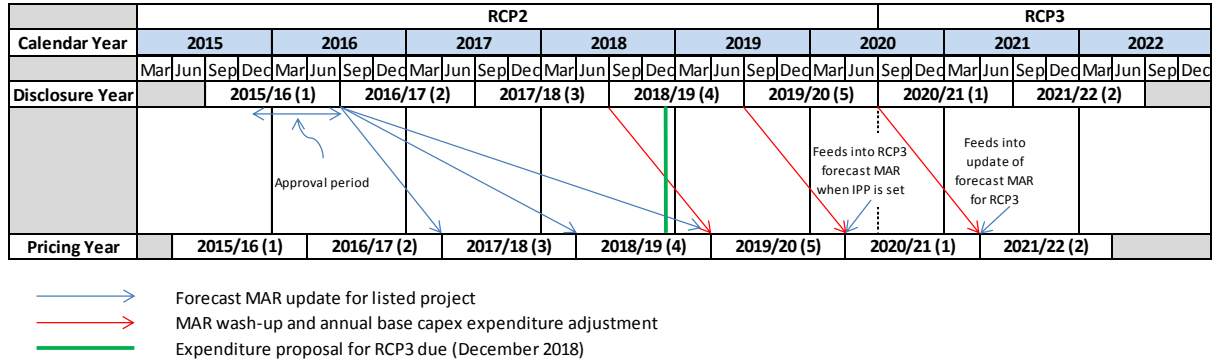
- 69.4 an adjustment correcting for the disparity between the forecast FX rates and actual FX rates in respect of both the base capex allowance and the approved base capex in respect of the listed project for the 2019/20 disclosure year.
70. Any annual base capex expenditure adjustment that is calculated following the 2019/20 disclosure year will form part of the EV account balance at 30 June 2021 and as is the case for adjustments that will flow through from RCP1 to RCP2, we anticipate will be taken into account in the amount of the forecast MAR in the 2021/22 pricing year (ie, when the first forecast MAR update for RCP3 is made in November 2020 for the second pricing year of RCP3, which is an update after the individual price-quality path has been set for RCP3 in November 2019).
71. The result of the MAR washup calculation following the 2020 disclosure year would similarly form part of the EV account balance at 30 June 2021 and be taken into account in updating the forecast MAR for the 2021/22 pricing year.

Scenario 2: Application and approval of base capex in the first disclosure year, and after November 2015, in respect of listed project assets that are forecast to be commissioned in the third to final disclosure years of RCP2

72. This scenario highlights differences from Scenario 1 as a result of base capex approvals falling in or after November in a disclosure year. It will generally apply in the 2015/16 (and 2016/17 and 2017/18) disclosure year.
73. Transpower applies for approval of base capex in respect of a listed project in the disclosure year 1 July 2015 – 30 June 2016 (ie, 2015/16 disclosure year), but not in sufficient time for the Commission to consider and approve the base capex before November 2015.
74. The assets to which the base capex relates are forecast to be commissioned in one or more of the 2017/18 to 2019/20 disclosure years.
75. The scenario assumes the Commission will approve the base capex in respect of the listed project after November 2015.
76. By the second Wednesday in November 2016 the Commission updates the forecast MAR under the individual price-quality path to take account of the impact of the base capex in respect of the listed project on Transpower's revenue (ie, forecast MAR) in the pricing years:
- 76.1 1 April 2017 to 31 March 2018 (2017/18 pricing year);
- 76.2 1 April 2018 to 31 March 2019; and
- 76.3 1 April 2019 to 31 March 2020.

77. The key timeline steps for this scenario are set out in Figure 2.

Figure 2: RCP2 timeline for scenario 2



78. The effect of approving the base capex in or after November is to exclude the effect of any approved additional base capex from the forecast 2016/17 pricing year. Transpower will not benefit from inclusion of any additional base capex for that listed project in the adjusted base capex allowance in the base capex expenditure adjustment for the 2016/17 disclosure year. Although the overall position should be NPV neutral once the base capex is approved, it highlights the importance from a cash flow perspective for Transpower of making timely submissions of applications for approval relative to the November timing of updates of the forecast MAR.




Scenario 3: Application and approval of base capex in fourth disclosure year, and prior to November 2018, in respect of listed project assets that are forecast to be commissioned in the final disclosure year of RCP2 and in disclosure years of RCP3

- 79. This scenario illustrates the final time for base capex approvals under the listed project mechanism for RCP2 and shows the anticipated interface with the setting of revenues for RCP3.
- 80. Transpower applies for approval of base capex in respect of a listed project in the disclosure year 1 July 2018 – 30 June 2019 (ie, 2018/19 disclosure year), and in sufficient time for the Commission to consider and approve the base capex before November 2018.
- 81. The assets to which the base capex relates are forecast to be commissioned in the 2019/20 disclosure year and one or more years of RCP3.
- 82. The scenario assumes the Commission will approve the base capex relating to listed project assets that are forecast to be commissioned in RCP2 prior to November 2018.
- 83. By the second Wednesday in November 2018 the Commission updates the forecast MAR under the individual price-quality path to take account of the impact of the base capex in respect of the listed project on Transpower’s revenue (ie, forecast MAR) in the 1 April 2019 to 31 March 2020 pricing year (2019/20 pricing year).

84. Those key timeline steps for this scenario are set out in Figure 3.

Figure 3: RCP2 timeline for scenario 3

	RCP2												RCP3															
Calendar Year	2015			2016			2017			2018			2019			2020			2021			2022						
Disclosure Year	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
	2015/16 (1)			2016/17 (2)			2017/18 (3)			2018/19 (4)			2019/20 (5)			2020/21 (1)			2021/22 (2)									
Pricing Year	2015/16 (1)			2016/17 (2)			2017/18 (3)			2018/19 (4)			2019/20 (5)			2020/21 (1)			2021/22 (2)									

-  Forecast MAR update for listed project
-  MAR wash-up and annual base capex expenditure adjustment
-  Expenditure proposal for RCP3 due (December 2018)

85. At the conclusion of the 2019/20 disclosure year, the adjusted approved base capex for the purposes of determining the annual base capex expenditure adjustment under Schedule B1 of the Capex IM will be equal to:
- 85.1 the base capex allowance determined on 29 August 2014 for the 2019/20 disclosure year (\$213.1 million); plus
 - 85.2 the base capex approved by the Commission in respect of the listed project for the 2019/20 disclosure year; plus
 - 85.3 an adjustment correcting for the disparity between the forecast CPI and actual CPI in respect of both the base capex allowance and the approved base capex in respect of the listed project for the 2019/20 disclosure year; plus
 - 85.4 an adjustment correcting for the disparity between the forecast FX rates and actual FX rates in respect of both the base capex allowance and the approved base capex in respect of the listed project for the 2019/20 disclosure year.
86. Any annual base capex expenditure adjustment that is calculated following the 2019/20 disclosure year will form part of the EV account balance at 30 June 2021 and, as is the case for adjustments that will flow through from RCP1 to RCP2, we anticipate will be taken into account in the amount of the forecast MAR in the 2021/22 pricing year (ie, when the first forecast MAR update for RCP3 is made in November 2020 for the second pricing year of RCP3, which is an update after the individual price-quality path has been set for RCP3 in November 2019).
87. The result of the MAR washup calculation following the 2019/20 disclosure year would similarly form part of the EV account balance at 30 June 2021 and be taken into account in updating the forecast MAR for the 2021/22 pricing year.
88. The portion of base capex that relates to listed project assets that are forecast to be commissioned after the end of RCP2 would form part of the base capex proposal for RCP3. The proposal is required by the Capex IM to be submitted by Transpower to the Commission not later than the first working day in December 2018.

89. The base capex in respect of listed project assets that are forecast to be commissioned after the end of RCP2 would be determined by the Commission not later than the last working day in August 2019 as part of the base capex allowance for disclosure years of the RCP3 regulatory period.
90. The base capex in respect of listed projects, where the assets are forecast to be commissioned after the end of RCP2, has no effect on the forecast MAR for RCP2 or the adjusted approved base capex for the purposes of determining any annual base capex expenditure adjustment under Schedule B1 of the Capex IM for RCP2.

Scenario 4: After completion of detailed technical studies, Transpower considers forecast commissioning of assets in respect of a listed project will only occur in RCP3

91. The listed project mechanism only applies to the listed projects, and to base capex in respect of the listed project assets that are forecast to be commissioned in RCP2.
92. Assets in respect of this listed project are not forecast to be commissioned in RCP2.
93. Details of Transpower's expenditure proposal related to this listed project would form part of the base capex proposal for RCP3 submitted by Transpower to the Commission not later than the first working day in December 2018.
94. Base capex in respect of this listed project would be determined by the Commission not later than the last working day in August 2019 as part of the base capex allowance for the disclosure years of the RCP3 regulatory period.
95. The base capex of this listed project, where the assets are forecast to be commissioned after the end of RCP2, has no effect on the forecast MAR for RCP2 or the adjusted approved base capex for the purposes of determining any annual base capex expenditure adjustment under Schedule B1 of the Capex IM for RCP2.

5. Summary of draft amendments

96. This chapter summarises the draft amendments to the input methodologies that apply to Transpower to give effect to the listed project mechanism.
97. A summary of the draft amendments to the input methodologies giving effect to the listed project mechanism is outlined in Table 2.³⁰

Table 2: Summary of proposed provisions giving effect to the listed project mechanism

Feature	Given effect through . . .
Listed project mechanism applies for RCP2 only	Timeframe limitations within the Transpower IM and the Capex IM on when listed project applications can be made, and when updates to the forecast MAR can include the revenue impact of additional base capex in respect of listed projects
Expenditure in respect of listed projects is excluded from the base capex allowance determined in August 2014	Base capex allowance determined in <i>Setting Transpower's individual price-quality path for 2015-2020</i> [2014] NZCC 23 (29 August 2014) did not make provision for any base capex in respect of the listed projects
Listed projects are the five listed projects specified in the IPP ³¹	Definition of 'listed projects' in the Capex IM
Transpower may submit an application to the Commission for approval of base capex in respect of a listed project	Processes, requirements and evaluation criteria for base capex in respect of listed projects set out in the Capex IM
Revenue impact of base capex in respect of listed projects feeds into Transpower's individual price-quality path through annual updates to the forecast MAR	Amendments to reconsideration provisions of the Transpower IM: specification of price
Base capex expenditure in respect of listed projects is subject to the base capex incentive framework in the Capex IM	Amendments to annual base capex expenditure adjustment incentive mechanism formula in the Capex IM

³⁰ The technical drafting of the proposed draft amendments is described in detail in attached Commerce Commission "Draft Transpower Input Methodologies Amendments Determination 2014 (No.2)" (23 October 2014).

³¹ Schedule I of the IPP determination identifies the five listed projects.

6. How you can provide your views

98. This chapter sets out the process for making submissions on this paper and provides details on the next steps in the amendments process.

How you can provide your views

99. We are seeking views from interested parties before reaching a final decision on the input methodology amendments related to approval of base capex in respect of listed projects.
100. Submissions on the proposed draft methodology are due by **5pm, Friday 7 November 2014.**³²
101. In making our final decision we will have regard to previous submissions on the listed projects approval mechanism received in relation to the individual price-quality path and Transpower input methodology amendment consultation processes.
102. We made in-principle decisions on 29 August 2014 that Transpower's RCP2 individual price-quality path would include a mechanism to allow us to reconsider the forecast MAR to take account of approved base capex for five (large reconductoring) listed projects. We are therefore particularly interested at this point in your submissions regarding how we implement that approval mechanism.

Address for responses

103. You should address your responses to:

Dane Gunnell (Senior Analyst, Regulation Branch)
c/o regulation.branch@comcom.govt.nz

104. It would be helpful to include in the subject heading Submission (or Cross-submission) on Proposed Transpower IM Amendments October 2014.
105. Please provide responses in both MS Word and PDF file formats.

Requests for confidentiality

106. While we discourage requests for non-disclosure of submissions, we recognise that there may be cases where parties that make submissions wish to provide information in confidence. We offer the following guidance.
107. If it is necessary to include confidential material in a submission, the information should be clearly marked. Both confidential and public versions of the submission should be provided.
108. The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.

³² This date differs from the date in our notice of intention. This is because we now consider a shorter consultation period to be more appropriate given the small number of proposed changes.

109. We request that you provide multiple versions of your submission if it contains confidential information or if you wish for the published electronic copies to be 'locked'. This is because we intend to publish all submissions and cross-submissions on our website. Where relevant, please provide both an 'unlocked' electronic copy of your submission, and a clearly labelled 'public version'.

Next steps

110. Following receipt of submissions we intend to make final decisions on any amendments by 27 November 2014.