

# **Proposed amendments to input methodologies for Transpower New Zealand Limited related to the 2025 Transpower individual price-quality path**

**Draft decision paper**

**Date of publication:** 29 May 2024

## Associated documents

Publication date	Reference	Title
29 May 2024	978-1-991287-23-6	Transpower's individual price-quality path for the regulatory control period commencing 1 April 2025: Draft Decision
29 May 2024	978-1-991287-24-3	Transpower's individual price-quality path for the regulatory control period commencing 1 April 2025: Draft Decision: Attachment A – Revenue path
29 May 2024	978-1-991287-25-0	Transpower's individual price-quality path for the regulatory control period commencing 1 April 2025: Draft Decision: Attachment B - Capital expenditure
29 May 2024	978-1-991287-26-7	Transpower's individual price-quality path for the regulatory control period commencing 1 April 2025: Draft Decision: Attachment C - Operating Expenditure
29 May 2024	978-1-991287-27-4	Transpower's individual price-quality path for the regulatory control period commencing 1 April 2025: Draft Decision: Attachment D - Quality standards and grid output measures
29 May 2024	978-1-991287-28-1	Transpower's individual price-quality path for the regulatory control period commencing 1 April 2025: Draft Decision: Attachment E - Deliverability expenditure
29 May 2024	978-1-991287-29-8	[DRAFT] Transpower Individual Price-Quality Path Determination 2025
29 May 2024	978-1-991287-30-4	[DRAFT] Transpower Input Methodologies Amendment Determination 2024
29 May 2024	n/a	<a href="#">Understanding how changes to line charges may impact your electricity bill webpage</a>
29 May 2024	968-1-991287-33-5	Default price-quality paths for electricity distribution businesses from 1 April 2025 - Draft decision reasons paper
25 January 2024	978-1-991085-71-9	<a href="#">Transpower's individual price-quality path for the next regulatory control period - Issues Paper</a>
9 October 2023	978-1-991085-44-3	<a href="#">Transpower's individual price-quality path for 2025 to 2030 – Our process, decision-making framework, and approach for setting expenditure allowances, quality standards and the price path</a>
13 December 2023	978-1-991085-65-8	<a href="#">Report on the IM Review 2023: Part 4 Input Methodologies Review 2023 – Final decision</a>

13 December 2023	978-1-991085-68-9	<a href="#"><u>Transpower investment topic paper – Part 4 Input Methodologies Review 2023 – Final decision</u></a>
13 December 2023	[2023] NZCC 38	<a href="#"><u>Transpower Input Methodologies (IM Review 2023) Amendment Determination 2023</u></a>
07 October 2021	ISSN 1178-2560	<a href="#"><u>Consolidated Transpower individual price-quality path determination 2020</u></a>
14 November 2019	978-1-869457-70-9	<a href="#"><u>Transpower Individual Price-Quality Path from 1 April 2020 – Companion paper to final RCP3 IPP determination and information gathering notices</u></a>
29 August 2019	978-1-869456-54-9	<a href="#"><u>Transpower’s individual price-quality path from 1 April 2020 – Decisions and reasons paper</u></a>

Commerce Commission  
Wellington, New Zealand

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## Executive summary

- X1 This document is part of the package of draft decision documents on Transpower New Zealand Limited's (**Transpower**) individual price-quality path (**IPP**) for the fourth regulatory period starting on 1 April 2025 (**RCP4**).<sup>1</sup> The draft decision package was published on 29 May 2024. We seek submissions on our draft decision, which will inform our final decision for the IPP reset.
- X2 This paper sets out the proposed amendments to the input methodologies (**IMs**) which will apply to Transpower for the electricity lines services it provides in RCP4.
- X3 These are the only IMs we consider appropriate to change ahead of the RCP4 reset. A full statutory IM review (**IM Review**) was completed in 2023. This current amendment will provide an opportunity to make incremental changes to the IMs, allowing IPP implementation issues to be addressed for RCP4.

## Input Methodologies Amendments

- X4 Table X1 sets out a summary of the IM amendments we are proposing.

**Table X1 Summary of input methodologies amendments for Transpower**

IM Amendment	Description
<b>Implementation of Regulatory Asset Base (RAB) indexation</b>	Amend the RAB revaluation approach in the Transpower IM to require Transpower to apply revaluation to the opening RAB <i>after</i> applying depreciation and write-downs for disposed assets and lost assets to the opening RAB.
<b>Deliverability Reopener</b>	Introduce a new deliverability reopener in the Transpower IM for Transpower to seek additional funding throughout the period when it has achieved higher levels of staff recruitment in line with its forecasts.
<b>Quality Standards</b>	Amend the Transpower IM to allow us to amend the quality standards, after reconsideration of the Transpower price-quality path.
<b>Cook Strait HVDC cable replacement</b>	Amend the forecast EV adjustment formula to exclude any values associated with a deposit paid to secure a manufacturing slot for a replacement HVDC cable.
<b>Typographical and formatting changes</b>	Non-material typographical and formatting corrections.

<sup>1</sup> Information about RCP4 consultation dates and formats for submissions can be found on our website [here](#).

## Chapter 1 Introduction

### Purpose of the paper

- 1.1 This paper provides our draft decision and invites submissions on how we propose to amend the input methodologies for electricity transmission services (**Transpower IM**) contained in the Transpower Input Methodologies Determination 2010, as amended (**Transpower IM Determination**).<sup>2</sup>
- 1.2 The proposed amendments to the Transpower IM relate to our draft decision for Transpower’s fourth regulatory period commencing 1 April 2025 (**RCP4**) and have been assessed in accordance with the decision-making framework outlined in Chapter 2.

### The process we followed

- 1.3 The proposed IM amendments made in the draft Transpower IM amendments determination, and described in this paper, are made in accordance with s 52X of the Commerce Act 1986 (**the Act**).
- 1.4 We published a Process, Framework and Approach paper on 9 October 2023, and an Issues paper on 25 January 2024 in relation to the RCP4 reset of Transpower’s individual price-quality path (**IPP**), to invite stakeholder views at an early stage in our decision-making.<sup>3, 4</sup>
- 1.5 Our Process, framework and approach paper outlined the key dates in our IPP reset process, including the date of our draft decision, the dates for submissions and cross-submissions on our draft IPP decision, and the date for our final IPP decision. Our Issues paper outlined a range of issues we were considering, including flagging the potential considerations for practical IM implementation matters, and delivery risks.
- 1.6 We received a number of submissions and cross-submissions on our Process, framework and approach paper and our Issues paper. These submissions included material from Transpower setting out an alternative revaluation approach in implementing the RAB indexation decided in the IM Review.<sup>5</sup>

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<sup>2</sup> [Transpower Input Methodologies \(IM Review 2023\) Amendment Determination 2023](#) [2023] NZCC 38.

<sup>3</sup> Commerce Commission [“Transpower’s individual price-quality path for 2025-2030 – Our process, decision-making framework, and approach for setting expenditure allowances, quality standards and the price path”](#) (9 October 2023) (**Process, framework and approach paper**)

<sup>4</sup> Commerce Commission [“Transpower’s individual price-quality path for the next regulatory control period – Issues paper \(25 January 2024\) \(Issues paper\)”](#)

<sup>5</sup> Transpower [“Cross-submission on RCP4 Issues paper”](#) (13 March 2024) (**Transpower’s cross-submission on Issues paper**), and Transpower [“Cross-submission on RCP4 Issues paper comparison of indexation approaches”](#) (13 March 2024) (**Transpower’s cross-submission on Issues paper – comparing indexation approaches**)

- 1.7 In accordance with s 52V of the Act, we published a Notice of intention relating to the potential Transpower IM amendments set out in this paper on 17 April 2024,<sup>6</sup> this Notice of intention was amended on 15 May 2024 to include a further possible amendment.<sup>7</sup>
- 1.8 The potential IM amendments are set out in this paper. In reaching a view on the potential IM amendments we considered the submissions on the Issues paper.<sup>8</sup>
- 1.9 We seek stakeholder views on our draft decision set out in this paper and the draft decision package for RCP4. We have allowed four weeks for submissions and two weeks for cross-submissions. The draft decision is accompanied by draft amendment determinations showing how we propose to give effect to the proposed changes.

### **Structure of this paper**

- 1.10 Chapter 2 of this paper outlines our framework for considering the scope of consequential and necessary Transpower IM amendments and the decision-making framework we have applied in proposing the Transpower IM amendments.
- 1.11 Chapter 3 of this paper describes our proposed changes to the Transpower IM determination. It sets out:
- 1.11.1 the current relevant Transpower IM requirements;
  - 1.11.2 the proposed Transpower IM amendments and why we are proposing these changes; and
  - 1.11.3 how the proposed Transpower IM amendments meet the criteria in our decision-making framework.

### **Effective dates for proposed IM amendments**

- 1.12 Section 52W of the Act requires us to publish, by way of notice in the Gazette, a brief description of any IM amendment and the goods and services to which it applies, the reasons for determining that IM amendment and how we are making it publicly available.<sup>9</sup>

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<sup>6</sup> Available at [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0030/349905/RCP4-input-methodologies-notice-of-intention-17-April-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0030/349905/RCP4-input-methodologies-notice-of-intention-17-April-2024.pdf).

<sup>7</sup> Available at [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0023/352742/RCP4-input-methodologies-Amended-Notice-of-Intention-15-May-2024.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0023/352742/RCP4-input-methodologies-Amended-Notice-of-Intention-15-May-2024.pdf).

<sup>8</sup> Available at <https://comcom.govt.nz/regulated-industries/electricity-lines/electricity-transmission/transpowers-price-quality-path/2025-transpower-individual-price-quality-path>.

<sup>9</sup> Section 52W(1)(b) states that IM amendments are secondary legislation which means that the publication requirements for secondary legislation in the Legislation Act 2019 apply.

- 1.13 The proposed amendments discussed in this paper would take effect at the start of the day following publication in the Gazette in accordance with s 52W. For those amendments to take effect for the RCP4 Transpower IPP determination, we would expect to publish the proposed amendments in August 2024.

### **Materials released alongside this paper**

- 1.14 Alongside this paper, we have published:
- 1.14.1 Draft Transpower Input Methodologies Amendment Determination (**draft Transpower IM amendment determination**); and
  - 1.14.2 Transpower’s individual price-quality path for the regulatory control period commencing 1 April 2025 – Draft decision paper (and attachments).

### **How you can provide your views**

#### **Submissions on this paper**

- 1.15 We welcome your views on the matters raised in this paper and how we are proposing to give effect to our draft decision within our draft Transpower IM amendment determination within the timeframes below:
- 1.15.1 submissions by 5pm on Wednesday, 26 June 2024; and
  - 1.15.2 cross-submissions by 5pm on Monday, 15 July 2024.

#### **Address for submissions**

- 1.16 Please email submissions and cross-submissions to [infrastructure.regulation@comcom.govt.nz](mailto:infrastructure.regulation@comcom.govt.nz) with “Transpower IM amendments” in the subject line of your email.
- 1.17 We prefer submissions in both a format suitable for word processing (such as a Microsoft Word document), as well as a ‘locked’ format (such as a PDF) for publication on our website.

#### **Confidential submissions**

- 1.18 While we encourage public submissions so that all information can be tested in an open and transparent manner, we recognise that there may be cases where parties that make submissions wish to provide information in confidence. We offer the following guidance:
- 1.18.1 If it is necessary to include confidential material in a submission, the information should be clearly marked, with reasons why that information is confidential.



- 1.18.2 Where commercial sensitivity is asserted, submitters must explain why publication of the information would be likely to unreasonably prejudice their commercial position or that of another person who is the subject of the information.
  - 1.18.3 Both confidential and public versions of the submission should be provided.
  - 1.18.4 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.
- 1.19 Parties can also request that we make orders under s 100 of the Act prohibiting the publication or communication of any confidential information. If we receive a request we will exercise our judgement in deciding whether or not an order is appropriate and any order we make will apply for a limited time as specified in the order. We will provide further information on these orders if requested by parties.
- 1.20 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 on our website. Where relevant, please provide both an 'unlocked' electronic copy of your submission, and a clearly labelled 'public' version.

## Chapter 2 Decision making framework

### Purpose of this chapter

- 2.1 This chapter describes:
  - 2.1.1 our framework for considering potential Transpower IM amendments, which is relevant in considering what IMs may be appropriate to amend outside of the statutory IM review cycle under section 52Y of the Act; and
  - 2.1.2 the decision-making framework we have applied in proposing the Transpower IM amendments.

### Framework for considering the scope of potential Transpower Input Methodologies amendments

- 2.2 Our framework considers:
  - 2.2.1 the statutory context;
  - 2.2.2 our specific powers to amend Transpower IMs; and
  - 2.2.3 what we must take account of when amending Transpower IMs outside of the statutory IM review cycle under section 52Y of the Act.

### Statutory context

- 2.3 When considering amendments to IMs, we must consider the purpose of IMs and the purpose of Part 4. This section discusses the tensions between making changes to improve the regime and the certainty intended by the IMs.
- 2.4 The purpose of IMs, set out in section 52R of the Act, is to promote certainty for suppliers and consumers in relation to the rules, requirements and processes applying to the regulation, or proposed regulation, of goods or services under Part 4. To that end, section 52T(2)(a) requires all IMs, as far as is reasonably practicable, to set out relevant matters in sufficient detail so that each affected supplier is reasonably able to estimate the material effects of the methodology on the supplier. In that way, the IMs constrain our evaluative judgements in subsequent regulatory decisions and increase predictability.<sup>10</sup>

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<sup>10</sup> *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289, para [213].

- 2.5 However, some uncertainty remains inevitable.<sup>11</sup> As the Court of Appeal observed (in relation to a judicial review of decisions made in relation to IMs under Part 4) “certainty is a relative rather than an absolute value”,<sup>12</sup> and “there is a continuum between complete certainty at one end and complete flexibility at the other”.<sup>13</sup>
- 2.6 The section 52R purpose is primarily promoted by having the rules, processes and requirements set upfront prior to being applied by regulated suppliers or ourselves.
- 2.7 However, as recognised in sections 52X and 52Y, these rules, processes and requirements may change over time.
- 2.8 The power to amend an IM must be used to promote the policy and objectives of Part 4 of the Act as ascertained by reading it as a whole. It is clear that Parliament saw the promotion of certainty as being important to the achievement of the purposes of price-quality (PQ) regulation. While this is to an extent implicitly inherent in section 52A (for example, providing suppliers with incentives to invest in accordance with section 52A(1)(a)), it is also expressed in section 52R in relation to the purpose of IMs, but also in other aspects of the regime, such as the restrictions on reopening DPPs during their regulatory periods.<sup>14</sup>
- 2.9 When considering IM amendments, we must therefore be mindful that this may have a detrimental effect on:
- 2.9.1 the role that predictability plays in providing suppliers with incentives to invest in accordance with section 52A(1)(a); and
- 2.9.2 the role that the IMs play in promoting certainty for suppliers and consumers in relation to the rules, requirements, and processes in advance of being applied by us and suppliers in setting the IPP.
- 2.10 At times there will be a tension between making changes to improve the regime and better promote the section 52A purpose on the one hand, and certainty on the other.
- 2.11 While we will have regard to the section 52R purpose (and the other indications of the importance of promoting certainty), ultimately, we must nevertheless make decisions that we consider promote the section 52A purpose.

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<sup>11</sup> *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289, para [214].

<sup>12</sup> *Commerce Commission v Vector Ltd* [2012] NZCA 220, para [34].

<sup>13</sup> *Commerce Commission v Vector Ltd* [2012] NZCA 220, para [60].

<sup>14</sup> For further discussion see *Wellington International Airport Ltd & others v Commerce Commission* [2013] NZHC 3289, para [213]-[221].

- 2.12 Section 52A governs all our decision-making processes under Part 4, including our IM decisions. The other purpose statements within Part 4 are relevant matters but they should be applied consistently with section 52A.<sup>15</sup>
- 2.13 When making our decisions we must only give effect to these other purposes to the extent that doing so does not detract from our overriding obligation to promote the purpose set out in section 52A which is to promote the long-term benefit of consumers by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services:
- 2.13.1 have incentives to innovate and to invest, including in replacement, upgraded, and new assets;
  - 2.13.2 have incentives to improve efficiency and provide services at a quality that reflects consumer demands;
  - 2.13.3 have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and
  - 2.13.4 are limited in their ability to extract excessive profits.
- 2.14 Therefore, where the promotion of section 52A requires amendment to an IM, section 52R does not prevent us from making a change that is consistent with section 52A.

#### **Amendments inside and outside the input methodologies statutory review cycle**

- 2.15 This section considers the circumstances in which IMs may be amended and what must be taken into account when making amendments to IMs outside of the statutory review cycle.
- 2.16 All IMs must be reviewed at least once every seven years, as required by section 52Y. This process is key to delivering on the section 52R certainty purpose of IMs, while at the same time allowing the regime to mature and evolve in response to changing circumstances.
- 2.17 Given the certainty purpose of the IMs and the scheme set out in the Act to promote this purpose, we must carefully assess what amendments are appropriate to consider outside the statutory IM review cycle. Additionally, as noted previously, the predictability the IMs provide is key to promoting the section 52A purpose and, in particular, incentives to invest as required under section 52A(1)(a).

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<sup>15</sup> We note that the High Court, in *Wellington International Airport Ltd & Ors v Commerce Commission* considered that the purpose of IMs, set out in s 52R, is “conceptually subordinate” to the purpose of Part 4 as set out in s 52A when applying the “materially better” test. See *Wellington International Airport Ltd v Commerce Commission* [2013] NZHC 3289, para 165.

- 2.18 On the other hand, it is important that the IMs are fit-for-purpose going into an IPP reset, particularly as IM amendments made after a PQ path is determined (other than in limited circumstances) will not affect the PQ path until the next reset.<sup>16</sup>
- 2.19 Leading up to an IPP reset, we may therefore need to consider which topics are appropriate to consult on as potential section 52X amendments to identify changes to the IMs that are necessary to ensure that the price-quality paths are able to be workable and effective in promoting the outcomes in section 52A, as we have done in this case.

### **Amendments outside of the statutory input methodologies review cycle**

- 2.20 We generally focus on two types of amendments outside the statutory IM review cycle:
- 2.20.1 those that support incremental improvements to PQ paths; and
  - 2.20.2 those that enhance certainty about – or correct technical errors in – the existing IMs.
- 2.21 We generally consider it is not appropriate to consider ‘fundamental’ changes outside the statutory IM review cycle. Fundamental IMs are generally those that define the fundamental building blocks used to set PQ paths (listed in section 52T(1)(a)), and that are central to defining the balance of risk and benefits between suppliers and consumers.
- 2.22 However, we can and will reconsider fundamental building blocks where there is a compelling and urgent rationale for doing so.<sup>17</sup>

### **The decision-making framework we have applied**

- 2.23 In deciding whether to propose IM amendments as part of the RCP4 setting process, we are using a decision-making framework that we have developed over time to support our decision-making under Part 4 of the Act.<sup>18</sup>

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<sup>16</sup> Under s 53ZB(2) a PQ path must be reset by us with a new PQ path made by amending the PQ determination if: an IM changes as a result of an appeal under s 52Z; and that changed IM would have resulted in a materially different PQ path being set had the changed IM applied at the time the PQ path was set.

<sup>17</sup> An example of this was the reconsideration of the Part 4 WACC percentile decision in 2014. The compelling reason for this was criticism by the High Court of this decision in the IM merits appeal process, and the urgency was due to the upcoming default price-quality path and individual price-quality resets for EDBs and Transpower New Zealand Limited.

<sup>18</sup> See, for example, Commerce Commission “[Input methodologies review decisions: Framework for the IM review](#)” (20 December 2016), para 59 and Commerce Commission “[Amendments to Electricity Distribution Services Input Methodologies Determination – Reasons paper](#)” (26 November 2019), para 2.17-2.20.

- 2.24 This framework has been consulted on and used as part of prior processes (including our recent IM Review 2023) and helps provide consistency and transparency in our decision-making.
- 2.25 In our IM Review 2023 Framework paper, we considered the criteria to change an IM. We consider the criteria applied in the 2023 IM Review to still be relevant. Consistent with the IM Review 2023 Framework, in respect of each potential IM amendment we will consider whether the changes will:
- 2.25.1 promote the Part 4 purpose in section 52A of the Act more effectively;
  - 2.25.2 promote the IMs purpose in section 52R of the Act more effectively (without detrimentally affecting the promotion of the section 52A purpose); and/or
  - 2.25.3 reduce compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the section 52A purpose).
- 2.26 As part of these considerations, we will also consider whether the potential IM amendment would detrimentally affect the promotion of the section 52A purpose. As discussed in paragraphs 2.10 to 2.14 above, while section 52R is a relevant matter, section 52A governs our decision-making process under Part 4. We may, therefore, make an IM amendment that does not promote the IM purpose in section 52R more effectively than the current IM where we consider that would promote the section 52A purpose more effectively.
- 2.27 Further, we consider that we must generally only make IM amendments to promote the IMs purpose in section 52R, or to reduce costs or complexity, where this does not detract from our obligation to promote the purpose in section 52A.
- 2.28 We refer to the outcomes specified in paragraph 2.26 as the '**IM amendments framework outcomes**' in this paper.

## **Chapter 3 Proposed amendments to the Transpower Input Methodologies Determination**

### **Purpose of this chapter**

- 3.1 This chapter describes our proposed changes to the Transpower IM Determinations.
- 3.2 For each of these proposed changes, we explain:
  - 3.2.1 our current requirements;
  - 3.2.2 our proposed amendment; and
  - 3.2.3 how the proposed amendment is likely to promote an IM amendments framework outcome, as defined in Chapter 2.

### **Summary of proposed amendments**

- 3.3 In the course of the IPP reset process, we have identified amendments to the IMs that we consider necessary to give effect to the decision under consideration during the RCP4 reset and promote the Part 4 purpose in section 52A of the Act more effectively.
- 3.4 We are considering discrete IM amendments to give effect to five issues under consideration as part of the RCP4 reset – implementing RAB indexation, implementing a deliverability reopener, impact of reopeners on quality standards, and incentive implications on the deposit for new and replacement Cook Strait cables and correction of typographical errors.
- 3.5 We propose amending the Transpower IM Determinations as follows.

### **Implementation of Regulatory Asset Base (RAB) Indexation**

- 3.6 We are proposing to amend the revaluation approach for implementing RAB indexation. The revaluation approach which was determined in the IM Review is currently set out in the Transpower IM. While the implementation of the RAB indexation revaluation approach was not submitted on in the IM Review 2023, we have now received submissions on the issue resulting from Transpower's development of the price-quality path financial model and implementing of the Transpower IM. We received a cross-submission on our IPP Issues paper from Transpower where it suggested an alternative approach to the annual RAB revaluation calculation.

- 3.7 We consider the current approach set out in the IMs may give rise to additional regulatory complexity and burden. Transpower’s proposed methodology produces materially similar financial results while not detracting from the promotion of the long-term benefit of consumers and significantly reducing compliance burden and costs.
- 3.8 Our draft decision is to amend the RAB revaluation formula in clause 2.2.8 of the Transpower IM to apply revaluation each disclosure year to the opening RAB value after applying for the current year depreciation to the opening RAB.

### **Deliverability Reopener**

- 3.9 Our draft decision is to introduce a new deliverability reopener in the Transpower IM for Transpower to seek additional funding in each year of the period when it has achieved higher levels of staff recruitment in line with its forecasts.
- 3.10 In our draft decision on Transpower’s IPP determination for RCP4, we are proposing to apply a deliverability expenditure adjustment to Transpower’s allowance for RCP4.<sup>19</sup>
- 3.11 After evaluating Transpower’s expenditure, we found the majority to be prudent and efficient, however we had concerns regarding Transpower’s ability to recruit sufficient staff to deliver the work programme. We are therefore proposing to introduce a new deliverability reopener for Transpower to apply for the contingent expenditure (capped at the total expenditure adjustment amount) if it can provide evidence of staff recruitment in line with its forecasts.

### **Addition of quality standards to price-quality path reopeners**

- 3.12 We are proposing changes to the IMs to allow us to amend the quality standards applying to Transpower when we reconsider the IPP under the existing reopener provisions (referred to as **IPP reopeners**).
- 3.13 We consider the current inability for us to amend the quality standards as a consequence of an IPP reopener is a significant gap in the Transpower IM and should be remedied before the commencement of RCP4. The Transpower quality standards are aligned with the revenue-linked elements of grid output measures. In the IM Review 2023 our decision was to allow us to reconsider and amend the grid output targets, caps, collars and grid output incentive rates associated with revenue-linked grid output measures following approval of major capex or base capex as a listed project.<sup>20</sup>

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<sup>19</sup> Commission, “Transpower Individual Price-Quality Path for the period commencing 1 April 2025: Draft decision: Attachment E - Deliverability” (29 May 2024).

<sup>20</sup> Commerce Commission, “[CPP and in-period adjustment mechanisms topic paper, Part 4 Input Methodologies Review 2023 – Final Decision](#)” (13 December 2023), para 5.119.2.1



- 3.14 The changes we propose to clauses 3.7.12(1A) and 3.7.12(3) of the Transpower IM will determine general information requirements for Transpower’s applications for IPP reopeners with respect to major capex proposals and listed projects. Because these two types of IPP reopeners are not currently referenced in the IMs as “reopener events”, the information requirements are currently applied through clause 8.6 of the RCP3 IPP determination. We consider rationalisation of the information requirements from the IPP to the Transpower IM will ensure better consistency of treatment across all forms of the IPP reopeners and across all regulatory periods.
- 3.15 We have concluded that our proposed IM amendments for variations of the quality standards in an IPP reopener would better promote the purpose of Part 4, provide better certainty for Transpower and its customers in relation to the IMs and the IPP processes, and reduce costs and complexity, without detrimentally affecting the promotion of the Part 4 purpose.

#### **HVDC Cook Strait Cable replacement**

- 3.16 Our draft decision introduces a transitional EV account adjustment mechanism to exclude values associated with a deposit paid to secure the manufacturing of new and replacement Cook Strait cables. This amendment addresses a one-off specific issue that could give rise to negative incentives for Transpower as a result of the timing of payment of a large deposit in RCP3 to secure the manufacturing of new and replacement Cook Strait cables. The payment of this deposit is before the expected time of our approval of the capex under the project in early to mid RCP4. The issue arises because the payment of the deposit is in a different regulatory period to our evaluation and approval of the capex.

#### **Correction of typographical errors**

- 3.17 Our draft decision is to make the following amendments to correct typographical errors:
- 3.17.1 delete the definition of **forecast CPI**;
  - 3.17.2 replace “**other regulated goods or services**” with “other **regulated goods or services**” in clause 2.2.10(1)(g); and
  - 3.17.3 in the formula in clause 3.6.2(b), replace “*Adjustment to the opex incentive*” with “***Base year adjustment to the opex incentive***”.

## Regulatory Asset Base Indexation – Revaluation approach

### Current requirements

- 3.18 Clause 2.2.8 of the current Transpower IM (as determined in the IM Review 2023) requires a revaluation to be calculated for each disclosure year using the following approach:

Unallocated revaluation is-

$$\text{opening unallocated RAB value} \times \text{revaluation rate}$$

Revaluation is –

$$\text{opening RAB value} \times \text{revaluation rate}$$

- 3.19 Depreciation and asset write-downs for disposed assets and lost assets are then applied to the resulting revalued assets.

### Proposed amendments

- 3.20 We propose to amend the RAB revaluation formulae in clauses 2.2.8(1) and 2.2.8(2) of the Transpower IM to apply a revaluation each disclosure year to the opening RAB value after applying depreciation (which includes asset write-downs for value of disposed assets and lost assets) to the opening RAB as follows:

Unallocated revaluation will be-

$$(\text{unallocated opening RAB value} - \text{unallocated depreciation}) \times \text{revaluation rate}$$

Revaluation will be-

$$(\text{opening RAB value} - \text{depreciation}) \times \text{revaluation rate}$$

### Our reasoning

- 3.21 We have considered Transpower's cross-submission in relation to the implementation of RAB indexation and assessed its proposed approach against the criteria set out in our IM Review 2023 framework paper.

#### *Untethering of the RAB and the financial accounting fixed asset records*

- 3.22 We consider that the RAB revaluation approach set out in the IM Review 2023 would result in untethering between the regulatory accounting RAB roll forward calculation and the GAAP fixed asset value applying GAAP roll-forward methods.

- 3.23 Based on our internal modelling of the RAB roll forward, we have concluded that under the approach determined in the IM Review 2023, an asset will have some residual value at the end of its asset life, resulting from the revaluation which is rolled forward, even though the asset has reached the end of its service potential. We note there are mechanisms in the amended Transpower IM from the IM Review 2023 that address this untethering (see clause 2.2.8(3), which specifies the revaluation amount at the end of asset life is nil).
- 3.24 Transpower noted that its proposed revaluation approach is more consistent with the accounting treatment of asset revaluation and that the IM approach will cause an untethering.<sup>21</sup> To test the quantum of untethering, we have considered the level of residual value at the end of asset life under the IM Review 2023 approach compared to the residual value under Transpower's proposed approach. Based on our internal analysis, the IM compliant approach results in around a \$300,000 negative NPV at 2% inflation in residual value, while Transpower's proposed approach results in \$0 in residual value.
- 3.25 An approach that is NPV neutral is also more likely to reflect the financial capital maintenance principle and as such, is likely to better promote incentives for Transpower to invest.
- 3.26 As noted above, we consider Transpower's proposed approach is more likely to be reflective of GAAP fixed asset roll forward approaches. Under Transpower's proposed approach, the regulatory asset register is more likely to be aligned to its GAAP compliant fixed asset register. The alignment between the asset registers should produce an outcome where reconciliation between the registers is more "straightforward".<sup>22</sup> This is likely to result in lower compliance costs and reduce the risk of accumulating errors by keeping the RAB closely aligned with the audited GAAP fixed asset register. We explain this below.

*Systems development costs for implementation and BAU maintenance costs*

- 3.27 We accept Transpower's submission that there may be significant development costs associated with switching its current fixed asset records to an IM compliant approach, given the regulatory fixed asset register values and roll forward is different to the GAAP fixed register asset.<sup>23</sup> We also accept that there may be additional BAU costs once this system is implemented, as the regulatory asset register and the accounting asset register untethering (as we have explained above) will need to be reconciled.

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<sup>21</sup> Transpower NZ Limited, "[Cross-submission on RCP4 Issues paper](#)" (13 March 2024), para A10.

<sup>22</sup> Transpower NZ Limited, "[Cross-submission on RCP4 Issues paper](#)" (13 March 2024), para A20.2.2.

<sup>23</sup> Transpower NZ Limited, "[Cross-submission on RCP4 Issues paper](#)" (13 March 2024), para A20.2.

- 3.28 The development costs and the BAU costs for the proposed alternative implementation could be significantly less than applying the current IM approach,<sup>24</sup> due to the lesser complexity of development and accounting maintenance.
- 3.29 While Transpower has not quantified the cost required to implement IM compliant RAB roll forward systems on an asset-by-asset basis, Transpower has considered the high-level scope of work required to implement the systems and ongoing costs of compliance.
- 3.30 Transpower has provided us with a description of the scope of work required to implement and operate the roll-forward mechanics (including increased assurance costs and staffing levels). We consider it reasonable to expect significantly increased compliance costs associated with the scope of work Transpower has described. Therefore, we consider Transpower’s proposed approach would reduce compliance costs, both based on the likely initial implementation costs as well as the subsequent BAU costs.
- 3.31 On this basis, we consider that the alignment between the GAAP fixed asset register and regulatory fixed asset register is likely to result in significantly lower compliance costs, both in terms of initial upfront development costs as well as BAU operating costs for assurance and reconciliation between the accounts.

*Materiality of impact on the timing of recovery of revenue*

- 3.32 In considering whether Transpower’s proposed approach better promotes the Part 4 purpose, we undertook analysis to consider whether there would be differences to revenue and whether this would detrimentally affect consumers.
- 3.33 In its cross-submission, Transpower estimates that the initial revenue impact in RCP4 is around \$6.1 million a year on average, while the revenue will be roughly equivalent from around 2034 and become lower in approximately 2038.<sup>25, 26</sup> Transpower notes that the increase is around 0.8% increase in revenue in the first five years (ie, in RCP4).<sup>27</sup>
- 3.34 Based on our analysis of the model Transpower has provided, the difference between the revaluation approaches results in an increase of between \$5.5 million to \$6.7 million in revenue in each year of RCP4, or a 0.53% SMAR increase in each year.

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<sup>24</sup> That is, the Input Methodologies that apply from 1 April 2025, following the IM Review 2023. These are set out in the [Transpower Input Methodologies \(IM Review 2023\) Amendment Determination 2023](#) [2023] NZCC 38.

<sup>25</sup> Based on \$5 billion opening RAB, 7% WACC and 2% inflation.

<sup>26</sup> Transpower New Zealand Limited, [“Cross-submission on RCP4 Issues Paper”](#) (13 March 2024), Figure 4.

<sup>27</sup> Transpower New Zealand Limited, [“Cross-submission on RCP4 Issues Paper”](#) (13 March 2024), para A19.

- 3.35 We have assessed whether Transpower’s proposed revaluation approach has a material effect on the quantum and profile of revenue from its RAB as well as confirming the NPV equivalence of the approaches. Our worked example assumes an opening RAB value of \$5.3 billion (from Transpower’s revenue model) with no additional capex commissioned for 45 years, a WACC rate of 7.4% (65<sup>th</sup> percentile vanilla WACC) and 2% inflation.
- 3.36 Based on our modelling, we expect that over the life of the asset (being 45 years) the proposed approach results in a slightly more ‘tilted’ price path compared to the existing approach.<sup>28</sup> This comes from the front-loading of the recovery of some revenue in the earlier years while there is a reduction in revenue towards the end of the asset life compared to the approach implemented in the IM Review 2023.
- 3.37 We also consider that the revenue impact over the life of the asset is NPV neutral between the current method and the method proposed by Transpower.
- 3.38 Based on our analysis, we consider that the short run revenue impact of the proposed change is of relatively low materiality; it represents an initial increase of around 0.53% per year. This initial change will be offset by lower revenue as assets reach the end of life in the RAB.<sup>29</sup>
- 3.39 We consider Transpower’s approach is likely to be more consistent with satisfying the financial capital maintenance principle and does not result in differences in the long run, and therefore does not detrimentally affect the promotion of the Part 4 purpose in the long run.

*Rationale for considering amending the IM now*

- 3.40 We consider it is necessary to make this change before RCP4 commences.
- 3.41 This is because RAB indexation has not yet been implemented. RCP4 will be the first regulatory period that RAB indexation is to be implemented. Therefore, we consider it is important to change the revaluation approach before the next IM Review (due by December 2030) as Transpower will have already incurred sunk costs by that stage, which would remove some of the key compliance reduction benefits of the proposed approach.

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<sup>28</sup> The ‘tilted’ price path refers to a profile where, compared to the current IM approach, there is increased revenue recovery in the earlier years of the asset’s life followed by lower revenue recovery in the later years of the asset’s life.

<sup>29</sup> Notwithstanding new capex entering the RAB.

## Conclusion

- 3.42 We consider changing the revaluation approach in the Transpower IM to allow revaluation after applying depreciation to the opening RAB would better promote the Part 4 purpose as it would reduce compliance costs while not detrimentally affecting the promotion of the long-term benefit of consumers, consistent with the IM Review framework for change.

## Deliverability reopener

### Current requirements

- 3.43 Under clause 3.7.1 of the Transpower IM Principal Determination,<sup>30</sup> Transpower is able to seek a reconsideration of an IPP within a regulatory period for a range of external factors that are reasonably outside of its control, such as catastrophic events, change events and error events.
- 3.44 In the 2019 amendments to the IMs for Transpower and the IM review 2023,<sup>31, 32</sup> we introduced two new drivers to account for the inherent uncertainty in the enhancement and development (E&D) base capex portfolio and that associated with Anticipatory Connection Asset capacity.
- 3.45 Under the clause 3.7.1(2) of the Transpower IM Principal Determination,<sup>33</sup> there is no reopener event that allows for additional funding throughout the period when Transpower has achieved higher levels of staff recruitment in line with its forecasts.

### Proposed amendments

- 3.46 We propose amending the Transpower IM to introduce a new deliverability reopener for Transpower to seek additional funding throughout the period when it has achieved higher levels of staff recruitment in line with its forecasts.
- 3.47 In our draft decision on Transpower's IPP determination for RCP4, we are proposing to apply a deliverability expenditure adjustment to Transpower's allowance for RCP4.<sup>34</sup>

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<sup>30</sup> Most recently amended following the IM Review 2023: [Transpower Input Methodologies \(IM Review 2023\) Amendment Determination 2023](#) [2023] NZCC 38, which applies from 1 April 2025 for the purpose of the IPP.

<sup>31</sup> Commerce Commission, [Amendments to input methodologies for Transpower New Zealand Limited – Reasons paper](#) (28 August 2019), para 2.3.4.

<sup>32</sup> Commerce Commission, [Report on the IM Review 2023 – Part 4 IM Review 2023 – Final decision](#) (13 December 2023), para 11.5.3.7.2

<sup>33</sup> Most recently amended following the IM Review 2023: [Transpower Input Methodologies \(IM Review 2023\) Amendment Determination 2023](#) [2023] NZCC 38, which applies from 1 April 2025 for the purpose of the IPP.

<sup>34</sup> Commerce Commission, “Transpower Individual Price-Quality Path for the period commencing 1 April 2025: Draft decision: Attachment E – Deliverability expenditure” (29 May 2024).

- 3.48 After evaluating Transpower’s expenditure for our draft decision, we assessed the majority to be prudent and efficient. However, we had concerns regarding Transpower’s ability to recruit sufficient staff to deliver the work programme. We are therefore introducing a new deliverability reopener for Transpower to apply for the contingent expenditure (capped at the total contingent expenditure allowance) if it can provide evidence of staff recruitment in line with its forecasts.
- 3.49 We propose the following clause additions to Part 1, Subpart 7 of the Transpower IM:<sup>35</sup>
- 3.49.1 Add reopener event definition (iv) to clause 3.7.1(2)(b) of the Principal Determination, providing that a ‘reopener event’ includes where Transpower becomes eligible for a delivery risk adjustment under clause 3.7.9B. We have defined ‘delivery risk adjustment’ as an "increase to a base capex allowance or an opex allowance (or both) that reflects Transpower’s management of a delivery risk and is provided for in the IPP determination”;
- 3.49.2 Add a new reopener event for delivery risk adjustment to clause 3.7.2(1); and
- 3.49.3 Add delivery risk adjustment eligibility requirements as clause 3.7.9B including:
- 3.49.3.1 If the IPP determination provides for a delivery risk adjustment;
- 3.49.3.2 Transpower applies for an amendment of the IPP;
- 3.49.3.3 Transpower provides a certificate from the Chief Executive Officer certifying the accuracy and completeness of the evidence; and
- 3.49.3.4 complies with any other requirements specified in the IPP determination.

### **Our reasoning**

- 3.50 We consider that the proposed amendments promote the IM amendments framework outcomes because there is considerable uncertainty at the reset surrounding deliverability of the RCP4 work programme expenditure. By allowing Transpower the opportunity to seek additional funding later in the regulatory period, when there is evidence of staff recruitment in line with its forecasts:

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<sup>35</sup> Most recently amended following the IM Review 2023 in the [Transpower Input Methodologies \(IM Review 2023\) Amendment Determination 2023](#) [2023] NZCC 38, which comes into effect for the purposes of the IPP from Transpower’s first pricing year of RCP4 on 1 April 2025.

- 3.50.1 it reduces the risk of inefficient expenditure where Transpower receives an efficiency incentive (and limits ability to extract excessive profits, consistent with section 52A(1)(d)) at a cost to consumers for work it is not able to deliver over the period due to workforce constraints;
- 3.50.2 the additional expenditure promotes the long-term benefit of consumers by providing incentives to innovate and to invest under section 52A(1)(a) of the Act as Transpower is able to invest in projects; and
- 3.50.3 it reduces the risk that Transpower is prevented from delivering its full proposed work programme which we consider to be prudent, efficient and in the long-term interest of consumers if it can achieve the staff recruitment in line with its forecasts. This maintains incentives for Transpower to improve efficiency, obtain efficiency incentives, share the benefits with consumers and provide services at a quality that reflects consumer demands, consistent with sections 52A(1)(b) and (c) of the Act.

## **Ability to amend quality standards when we reopen Transpower's price-quality path**

### **Current requirements**

- 3.51 Under clauses 3.7.11 and 3.7.12 of the current Transpower IM, when there is an IPP reopener we may currently only amend the price path, grid output targets, caps, collars, and grid output incentive rates associated with revenue-linked grid output measures.
- 3.52 Clause 3.7.11(1) currently states that:
  - (1) If the Commission decides that the IPP should be amended, the Commission may amend any 1 or more of the following that are specified in the IPP determination:
    - (a) price path;
    - (b) grid output targets;
    - (c) caps;
    - (d) collars; and
    - (e) grid output incentive rates associated with revenue-linked grid output measures.
- 3.53 This means that Transpower's quality standards cannot currently be amended during each five-year regulatory period (ie, only at the IPP resets prior to each regulatory period).



- 3.54 This contrasts with the ability of electricity distribution businesses (**EDBs**) to propose under clause 4.5.5 of the EDB IMs a quality standard variation (**QSV**) during the default price-quality path regulatory period. A QSV is a variation of the value of the quality standard or incentive measure metric, but not a change in the design of the metric itself.
- 3.55 We note that reopening of the IPP to reflect approvals of additional major capex or approvals of base capex listed projects are dealt with separately from all other types of reopener events. Clause 3.7.12(2) therefore currently states, similar to clause 3.7.11(1), that:

(2) If the Commission decides, having reconsidered the IPP under subclause (1), that the IPP should be amended, the Commission may amend any 1 or more of the following that are specified in the IPP determination:

- (a) price path;
- (b) grid output targets;
- (c) caps;
- (d) collars; and
- (e) grid output incentive rates associated with revenue-linked grid output measures.

### **Proposed amendments**

- 3.56 We consider the current absence of reference to the quality standards in the list of IPP components that may be amended as a consequence of an IPP reopener is a gap in the Transpower IM and should now be remedied before the commencement of RCP4.
- 3.57 However, rather than establishing a separate QSV in the Transpower IM, we propose to incorporate the features of a QSV-like approval into the IPP reopener provisions in the Transpower IM.
- 3.58 The changes we propose to introduce in clauses 3.7.11(1)(ab) and 3.7.12(2)(ab) of the Transpower IM will allow us, after reconsideration of the Transpower price-quality path, to amend the values in a quality standard applying to Transpower in the IPP.
- 3.59 Under this draft decision, any changes would apply to the values of the quality standard, but not to the design features of the quality standard itself.
- 3.60 We propose the following drafting for Clause 3.7.11(1)(ab) (and similar drafting for clause 3.7.12(2)(ab)):

(1) If the **Commission** decides that the **IPP** should be amended, the **Commission** may amend any 1 or more of the following that are specified in the **IPP determination**:

- (a) price path;
- (ab) quality standard values (that is, any value that, if met, means a quality standard is attained);
- (b) grid output targets;
- (c) caps;
- (d) collars; and
- (e) grid output incentive rates associated with revenue-linked grid output measures.

- 3.61 Other related changes we propose to clauses 3.7.12 (in addition to the proposed clause 3.7.12(2)(ab)) are designed to help integrate requirements for IPP reopeners with respect to approvals of major capex and listed projects.
- 3.62 The two IPP reopeners for major capex and listed projects are not currently referenced as “reopener events” in the Transpower IM and the information requirements for these are currently applied through clause 8.6 of the RCP3 IPP determination, which would be deleted from the IPP once the IM amendment is finalised. We consider this rationalisation of the requirements from the IPP to the Transpower IM will ensure consistency of the treatment across all forms of the IPP reopeners.

### **Our reasoning**

- 3.63 During the course of making our draft decision for RCP4 on quality standards in conjunction with our draft decision on capex, we identified that the absence of our ability to recalibrate the values in the Transpower quality standards during a regulatory period in response to potentially major investments of additional capex could cause unintended breaches of the quality standards that we are currently setting for RCP4. The additional investment may alter the overall scale of the grid, which in some cases may require the quality standards to also be proportionately adjusted.
- 3.64 On reviewing the Transpower IM as they currently apply to reopener events, we also identified that other significant reopener events such as catastrophic events such as major storm emergencies or earthquakes could also give rise to these unintended breaches.

- 3.65 We are therefore proposing more flexibility in our setting of the values in the quality standards during a regulatory period, similar to the EDB QSV approach and the reopener approach for gas distribution and transmission.<sup>36,37</sup> This is to avoid breaches of the quality standards that do not reflect performance issues by Transpower that could require further investigation or sanction.
- 3.66 We consider it is necessary to amend the Transpower IM to give effect to this decision. This is because s 52T(1)(c)(ii) of the Act requires that the IMs to specify the “circumstances in which price-quality paths may be considered within the regulatory period;”.
- 3.67 We consider that the proposed IM amendments for variations of the Transpower quality standards in an IPP reopener would closely align with the revenue-linked grid output measures and will promote the Part 4 purpose in s 52A of the Act more effectively by allowing appropriate adjustments to be made through the Transpower reopener processes.

## **RCP4 Transitional EV account adjustment for HVDC Cook Strait Cable replacement**

### **Current requirements**

- 3.68 The current formula for forecast EV account adjustments only adjusts the EV account for WACC. We discuss the problem definition under the current IM requirements in chapter 3 of the RCP4 Draft Decision Attachment A – Revenue path design.

### **Proposed amendments**

- 3.69 Our draft decision to introduce an RCP4 HVDC transitional EV account adjustment mechanism is to address a one-off specific issue that could give rise to negative incentives for Transpower as a result of the timing of payment of a large deposit to secure the manufacturing of new and replacement Cook Strait cables in RCP3, which is before the expected time of our approval of the capex under the project in early to mid RCP4. The mechanism, which is described in more detail in our RCP4 draft revenue paper,<sup>38</sup> addresses this issue by:

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<sup>36</sup> The Gas distribution DPP IMs allow us to amend the quality standards after reconsideration of the DPP (subject to specific limitations for capacity events and risk events) under clauses 4.5.5 and 4.5.6(2)(b) of the *Gas Distribution Services Input Methodologies Determination 2012* (as consolidated as of 23 April 2024).

<sup>37</sup> The Gas transmission DPP IMs allow us to amend the quality standards after reconsideration of the DPP (subject to specific limitations for capacity events and risk events) under clauses and 4.5.5 and 4.5.6(2)(b) of the *Gas Transmission Services Input Methodologies Determination 2012* (as consolidated as of 23 April 2024).

<sup>38</sup> Commerce Commission, “Transpower’s individual price-quality path for the regulatory control period commencing 1 April 2025, Draft Decision Attachment A – Revenue path design” (29 May 2024), Chapter 3.

- 3.69.1 amending the Transpower IM determination to exclude any amount of an EV account entry relating to a base capex adjustment incentive penalty for this deposit from the calculation of the forecast EV adjustment for RCP4 in clause 3.1.1(5); and
- 3.69.2 introducing the 'RCP4 HVDC transitional EV account adjustment' into the RCP4 IPP to offset during RCP4 any negative incentive entry applied as a result of the timing of this payment. This will permanently eliminate this amount from the EV account.

### **Our reasoning**

- 3.70 We consider our draft decision is necessary to promote the Part 4 purpose in s 52A, considering the IM purpose in section 52R with respect to the draft IM amendment.
- 3.71 We consider the adjustments we are proposing in the IPP to remove the cost of the negative capex incentives from Transpower will have the outcome of incentivising Transpower to make the necessary plans to invest in replacing and upgrading the Cook Strait cables, including securing manufacturing capacity, to provide electricity transmission services at a quality that its customers demand, and share with its customers the benefits of efficiency gains in relation to the project.
- 3.72 This is because the alternative of us doing nothing would impose an (unavoidable) incentive cost on Transpower for paying a deposit to secure a manufacturing slot for this significant asset – that is, a penalty for conduct that we ought to be incentivising, not penalising under s 52A.
- 3.73 The IM amendment to the forecast EV adjustment in clause 3.1.1(5) of the Transpower IM determination will promote certainty for Transpower and its customers of how the Transpower IM will apply for the RCP4 IPP determination in relation to the treatment of the contract deposit and the resulting treatment of the negative capex incentive amount in RCP4.