

The Review of the Independent Engineers' Reports
on the Asset Adjustment Process of Electricity
Distribution Businesses

Draft Addendum Report
August 2012

Prepared for



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STATEMENT OF INDEPENDENCE

This review has been conducted under the terms and conditions as specified in the Agreement entered into by Nel Consulting Limited (NCL) for this project.

The review required NCL to rely extensively on data provided by the non-exempt electricity distribution businesses (EDBs), including the Independent Engineers' Reports and other documents submitted during the course of this review.¹ NCL was not required to independently verify the accuracy of this information, nor audit any financial information. It is for this reason that the accuracy of this review was highly dependent on the information provided to NCL. Where inconsistencies or conflicts were found in the data provided, NCL exercised its own best judgment to resolve the said inconsistencies or requested further clarification.

NCL confirms that, to the extent possible and with the information available, the review results have been determined in an independent and unbiased manner, by applying the methodology as set out in this report, and represent our best financial and technical judgments in support of the comments or recommendations made in this report.

¹ The information provided for this project includes Schedule A – A6, the Independent Engineer's Report (including any attachments submitted as part of the Engineer's Report), additional information provided by the EDBs in response to the Commission's Notice dated 15 June 2011, information provided in response to the Commission's letter dated 2 September 2011, and information provided in response to the Commission's Paper dated 19 June 2012.

1. INTRODUCTION

NCL was contracted by the Commerce Commission (Commission) to undertake a review and provide advice on the Independent Engineers' Reports received from the EDBs by the Commission as part of statutory information requests made under the Commerce Act 1986 (the Act). These statutory information requests relate to the requirements under Part 4 of the Act for the Commission to set default price-quality paths (DPPs) for suppliers subject to default price quality regulation.

In order to inform its decision on setting DPPs, the Commission requested information from the non-exempt EDBs by way of notice under 53ZD of the Act on 16 March 2011 (Information Request). Consistent with relevant input methodologies determined by the Commission in December 2010 – Commerce Act (Electricity Distribution Services Input Methodologies) Determination 2010 (EDB IMs), an EDB is permitted to undertake an 'asset adjustment process' in determining its initial regulatory asset base. Such process allows EDBs to modify the starting value of their asset base from the value disclosed as at 31 March 2009 under existing EDB information disclosure requirements.

The Commission's Information Request set out the minimum information requirements necessary to be disclosed by an EDB in relation to adjustments to asset values, and, among other things, required an Independent Engineer's Report to be completed by an independent engineer in accordance with the requirements of Schedule C of the Information Request.

NCL submitted its review of the Independent Engineers' Reports on the asset value adjustments including the additional information provided by the EDBs which was taken into consideration by the Commission in its draft decisions in relation to the resetting of the 2010 to 2015 DPPs for the EDBs. Further to this process, the Commission issued a letter on 2 September 2011 indicating the need for EDBs to potentially amend its submission with regards to the information required to undertake the asset adjustment process, as well as issued a Guidance² that explains how to correct for the types of errors referred to in the aforementioned letter.

In response to the 2 September 2011 letter issued by the Commission, the following EDBs submitted either additional information or revised Independent Engineers' Reports:

1. OtagoNet Joint Venture (OJV);
2. Vector Limited (Vector); and
3. Wellington Electricity Lines Limited (Wellington Electricity).

On 19 June 2012, the Commission issued a Paper³ in relation to the default price-quality paths for EDBs and gas pipeline businesses (GPBs). The Paper informed the EDBs of the updated process on the regulatory asset base adjustments and further informed the EDBs that where the previously supplied information on permitted asset value adjustments satisfies the requirements of the Information Requests, the Commission will use the information for the potential reset. On the other hand, any outstanding queries in relation to the submitted

² Electricity Distribution Businesses Notice to Supply Information to the Commerce Commission – Guidance, Commerce Commission, September 2011.

³ Process Update – Default Price-Quality Paths for Electricity Distribution and Gas Pipeline Services, Commerce Commission, 19 June 2012.

information will also be communicated with the relevant EDBs. This report summarises NCL's review of EDBs' responses to the Commission's 2 September 2011 letter, as well as the additional information provided by the EDBs following the communications after the issuance of the 19 June 2012 Paper.

For completeness, this report also includes a table summarising NCL's recommended asset value adjustments for all the EDBs who have elected to undertake the asset adjustment process following the reviews undertaken by NCL for the Commission. The tables can be found in Appendix A of this report. In summary, the following EDBs have submitted proposed asset value adjustments:

1. Alpine Energy Limited (Alpine);
2. Aurora Energy Limited (Aurora);
3. Eastland Network Limited (Eastland);
4. Horizon Energy Distribution Limited (Horizon Energy);
5. Nelson Electricity Limited (NEL);
6. Network Tasman Limited (Network Tasman);
7. OtagoNet Joint Venture (OJV);
8. Powerco Limited (Powerco);
9. The Lines Company Limited (TLC);
10. Top Energy Limited (Top Energy);
11. Unison Networks Limited (Unison);
12. Vector Limited (Vector); and
13. Wellington Electricity Lines Limited (Wellington Electricity).

2. REVIEW OF ADDITIONAL/REVISED SUBMISSIONS

2.1 INTRODUCTION

As per the EDB IMs⁴, an EDB is permitted to adjust their initial regulatory asset base values from those previously disclosed as at 31 March 2009 (2009 disclosed assets). To be able to do this however, an EDB must comply with the minimum information requirements set out in Schedule C of the Commission's Information Request. The Information Request clearly specifies foremost compliance to the asset adjustment process as set out in clause 2.2.1 of the EDB IMs.

The adjustment process detailed in the EDB IMs stipulates that an EDB may choose to undertake none, some or all of the following adjustments:

1. Designate a load control relay asset owned by an EDB as an 'included asset', except where it is already included in 2009 disclosed assets;
2. Correct the following types of asset register errors where the error relates to 2009 disclosed assets;
 - a. Assets omitted in error;
 - b. Assets included in error; and
 - c. Assets allocated to an incorrect asset category, or given an estimation of quantity, age, category or location now known to be incorrect.
3. Re-apply a multiplier used to value a 2009 disclosed asset in a 2004 optimised deprival valuation (ODV) where more accurate information relating to the application of the multiplier has subsequently become available;
4. Re-apply the following types of multiplier in the manner described below:
 - a. Rugged Terrain Multiplier may be amended to the range specified in the EDB IMs and may also be applied to non-standard designs of overhead line networks;
 - b. The Business District Multiplier may be amended to the range specified in the EDB IMs; and
 - c. The Rocky Ground Multiplier may be amended to the range specified in the EDB IMs and may also be applied to cables laid in loose rock or sand.
5. For a 2009 disclosed asset whose value was affected by the application of an optimisation or economic value test in a 2004 ODV, the asset may subsequently be included, excluded or its value modified from its value in 2009 disclosed assets.

Furthermore, clause 2.2.2 of the EDB IMs set out the specific assets that should be included and excluded in the regulatory asset base; thus, the EDB's proposed adjustments to the initial regulatory asset base in terms of proposed correction of assets omitted and included in error should be consistent with what is allowed for in the EDB IMs.

⁴ Commerce Act (Electricity Distribution Services Input Methodologies) Determination 2010, Commerce Commission, 22 December 2010.

As per the EDB IMs, EDBs should exclude the following from their regulatory asset base:

1. Assets not used to supply electricity distribution services;
2. Designated as 'excluded' type as a result of the asset adjustment process;
3. Easement land;
4. Intangible assets, unless they are
 - a. Finance leases; or
 - b. Identifiable non-monetary assets; and
5. Works under construction.

On the other hand, the following are allowed to be included in the regulatory asset base value:

1. 2009 disclosed assets; and
2. An asset which, as a result of the asset adjustment process is designated as 'included'.

2.2 OJV

Following OJV's submission of the Independent Engineer's Report (including the additional information provided by OJV) and the review undertaken by NCL of the aforementioned submission which was taken into consideration by the Commission in its draft decision in relation to the resetting of the 2010 to 2010 DPP for OJV, OJV has continued to assess their 2004 ODV data/information sources and subsequently requested their independent engineer to review the modifications to its 2004 regulatory asset base. This section summarises NCL's review of the third version of the Independent Engineer's Report submitted to the Commission for consideration. It is worth noting that no comparison between previous submissions from OJV was made, because the third version of the Independent Engineer's Report supersedes all other previous submissions.

NCL's review of the Independent Engineer's Report submitted by OJV is presented in Appendix B of this report. This portion of the review focuses on the EDB's compliance to the information requirements set out in Schedule C of the Commission's Information Request. A more comprehensive review was conducted by NCL for certain aspects of the submission which are discussed in more detail in the succeeding sub sections.

Appendix B lists the different minimum requirements for an Independent Engineer's Report as well as the minimum information requirements for each proposed adjustment. Where NCL believes a particular information submission is unclear or insufficient, we have indicated the reason for uncertainty or specified additional information that may be submitted in order to ascertain the compliance to a particular requirement.

The following tables summarise the results of NCL's review of OJV's compliance to Schedule C and Table 1 of the Commission's Information Request.

Table 1: General Compliance to Schedule C Requirements

SCHEDULE C - General Compliance					
EDB	The report must be completed by an 'engineer' as defined in clause 1.1.4 of the EDB Input Methodologies	The report must be in writing and accessible in electronic format	The report must include a copy of the written instructions provided to the engineer by the EDB	The report must include a table summarising the various asset value adjustments and corresponding to Schedule A4 of the Information Disclosure Notice Templates	The report must include a signed statement by the engineer
OJV	Yes	Yes	Yes	Yes	Yes

Note: Refer to Appendix B for details regarding the analysis presented in the table above.

'Yes' means that the EDB has complied with the requirements set, whereas 'No' means that the EDB has not fully complied with a specific requirement.

From the table above it can be observed that OJV is compliant with the requirements set in Schedule C.

In relation to the assessment of OJV's compliance to Table 1 of the Commission's Information Request, particularly for OJV's proposed register error corrections, NCL notes that from the Independent Engineer's Report, OJV has proposed to correct asset register errors in relation to the following assets:

- Reclosers;
- 11kV cables and LV cables;
- Distribution substation fuses;
- Regulating transformers;
- Kiness Structure;
- Streetlight ICPs; and
- Distribution substation maximum demand indicators (MDIs).

The table below summarises NCL's compliance assessment of OJV's above proposed adjustments, with the requirements set in Table 1 of the Commission's Information Request.

Table 2: Compliance to Schedule C Table 1 – Load Control Relays and Register Error Corrections

SCHEDULE C - Table 1 Compliance - Load Control Relays and Correction of Asset Register Errors								
EDB	Load Control Relay		Correct Asset Register Errors					
	Included		Included	Excluded	Value Modified			
	Number and Description	DHC or Depreciated Carrying Value	Description and Value	Description and Value	Description and Type of Error	Value of Each Asset	Calculation of Relevant Adjustment	Resultant Modified Value
OJV	N/A	N/A	Yes	N/A	Yes	Yes	Yes	Yes

Note: Refer to Appendix B for details regarding the analysis presented in the table above.

'Yes' means that the EDB has complied with the requirements set, whereas 'No' means that the EDB has not fully complied with a specific requirement.

As can be seen from the table above, OJV has complied with the requirement set in Table 1 regarding adjustments for correction of asset register errors.

It should however be noted that in addition to the asset register error corrections presented in the Independent Engineer's Report, OJV submitted additional information in relation to a proposed adjustment for zone transformers. The review of this proposed adjustment is discussed in Section 2.2.2 of this report.

Table 3: Compliance to Schedule C Table 1 – Multipliers

SCHEDULE C - Table 1 Compliance – Multipliers							
EDB	Re-apply Existing multiplier			Re-apply Modified Multiplier			
	Value Modified			Value Modified			
	Description and ODV Value for Each Asset	Description of More Accurate Information	Calculations Used and Resultant Modified Value	Description and ODV Value for Each Asset	New Multiplier and Reason for Selection	Supporting Facts and Reasons	Calculations Used and Resultant Modified Value
OJV	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Note: Refer to Appendix B for details regarding the analysis presented in the table above. 'Yes' means that the EDB has complied with the requirements set, whereas 'No' means that the EDB has not fully complied with a specific requirement.

It is apparent from the table above that OJV has complied with the requirement set in Schedule C regarding adjustments for multipliers.

OJV has not proposed any optimisation or economic value (EV) adjustments to their 2004 regulatory asset base.

2.2.1 Multiplier Related Asset Value Adjustments

The most material adjustment proposed by OJV relates to that of changes as a consequence of re-applying an existing or modified multiplier. These proposed adjustments are allowed as per the EDB IMs which states that an EDB may re-apply a multiplier in an ODV valuation where better information has subsequently become available. Furthermore, the Commission revised the multiplier ranges set in the 2004 ODV Handbook⁵ to as follows:

- Rugged terrain multiplier now range from 1.2 to 1.8 times and may also be applied to non-standard designs of overhead line networks that accommodate difficult physical or climatic conditions involving swampy ground, high winds or snow;
- Business district multiplier now range from 1.15 to 2.5 times; and
- Rocky ground multiplier now range from 1.0 to 2.0 times and may also be applied to cables installed in loose rock or sand.

The Independent Engineer's Report for OJV identifies four adjustments in relation to their application of multipliers that were used in their 2004 ODV as listed below:

- Applying the remote multiplier to zone substation assets;
- Redefining the boundary for remote assets;

⁵ Handbook for Optimised Deprival Valuation of System Fixed Assets of Electricity Lines Businesses, Commerce Commission, 30 August 2004.

- Redefining the regions to which the rugged multiplier is applied; and
- Increase the magnitude of the rugged multiplier.

OJV is proposing to apply the remote multiplier to a wider range of zone substation equipment than those used in the 2004 ODV. The independent engineer reviewed the expansion of the remote multiplier and considers it to be appropriate. NCL notes that even though the level of multiplier applied to the wider range of equipment is similar to those used in the 2004 ODV (1.15), the reasons for applying the same multiplier could have been made clearer for this category of adjustment. Another observation is that even though the ODV Handbook states in A.9 that where appropriate, remote area multipliers may also be applied to the unit rates as presented in the ODV Handbook, it is not clear how unit rates were obtained for items for which no unit rates are provided in the ODV Handbook (for example Site Development and Buildings, Transformers, etc.). Moreover, it is unclear if these unit rates have been derived from actual costs rather than a fair average unit rate. If it was derived from actual costs, then NCL is of the view that the multiplier should not be applied. However, NCL assumes that the independent engineer investigated this matter and therefore considers the multiplier application to be appropriate. NCL further notes that the proposed adjustment in relation to applying the remote multiplier is not material to the overall proposed adjustment.

OJV is proposing to extend the region classified as remote by identifying the 75 kilometer boundary for this area by road distance rather than a straight line radius based identification. This is consistent with the intention of Schedule C and the ODV Handbook.

The Independent Engineer's Report has indicated that since 2004, OJV has improved their geographic information system (GIS) which was then used to better define the areas identified by OJV as rugged terrain. NCL notes that the total length of the line identified to be situated in rugged terrain is proposed to increase from 435 kilometers (as identified in the 2004 ODV) to 1,771 kilometers which is substantial. The independent engineer performed field audits as well as random checks as part of the current adjustment process to test the validity of the proposed rugged terrain expansion. Based on the review performed by the independent engineer, NCL recommends no further action in relation to the adjustment associated with the rugged terrain multiplier.

In relation to the rugged multiplier used by OJV in their previous valuation of 1.2, OJV investigated historic project costs and found that the multiplier of 1.2 may be too low. The independent engineer requested OJV to obtain a recent quotation for a typical line built in rugged terrain in their area and after reviewing the quotation, recalculated the rugged multiplier to be 1.6 rather than 1.2 by using PPI (Construction) for deflation and comparing the quotation cost with that of the ODV Handbook. No economies of scale consideration were applied due to the size of the project used as the basis for the cost and additional costs foreseen but not added to the calculations. NCL notes that there are numerous variables used in this assumption that may change the outcome, however it is assumed and in some cases can be concluded from the Independent Engineer's Report that the independent engineer has considered all options. NCL notes that there was no mention of the potential impact from competitive bidding which may have impacted the calculation. NCL further notes that the Independent Engineer's Report could have been improved by including some recent cost comparisons between lines built in a rural environment versus a rugged area to further support the proposed adjustment. However, the independent engineer has stated that it has reviewed the documents and information provided by OJV and is of the view that it is reasonable. Therefore, based on the independent engineer's assessment that the adjustment is deemed to be reasonable, NCL proposes no further action.

2.2.2 Zone Transformer Asset Value Adjustments

In addition to the Independent Engineer's Report, OJV submitted information in relation to a proposed adjustment for zone transformers. The additional information included a Directors' certificate, a letter from Sinclair Knight Merz (SKM) in relation to the proposed zone transformer adjustment, and updated tables as it relates to the Commission's Information Disclosure template.

NCL notes that the EDB IMs is clear on what adjustments are allowed under the 'value modified' category and these adjustments include: assets allocated to the incorrect asset category, or given an estimation of quantity, age, category or location now known to be incorrect. The EDB IMs does not specifically include changes to replacement costs as proposed by OJV for zone transformers.

Moreover, the independent engineer has also indicated the following in their Independent Engineer's Report:

"Zone transformer replacement costs. OJV is of the view that the zone transformer replacement costs adopted for the 2004 ODV were too low. The increases proposed by OJV have not been reviewed or included by SKM in the Adjusted RAB on the basis that Commerce Commission's asset adjustment process does not make allowance for changes in asset replacement costs."

Subsequently, SKM did perform an analysis of replacement costs for zone transformers and provided the outcome from this exercise in a letter to OJV, dated 12 June 2012 with reference ZP01289. From this letter SKM has stated that in their opinion, the updated zone substation transformer replacement costs are reasonable and that their opinion is intended to be used only to establish OJV's 2004 electrical asset valuation in accordance with the ODV Handbook. However, it is clear from the letter that SKM did not state that the proposed zone transformer replacement cost changes are in accordance with the asset adjustments allowed by the Commission's asset adjustment process. Furthermore, the letter appears to be a separate document rather than an addendum to the existing Independent Engineer's Report.

Based on the fact that the proposed adjustment does not form part of the adjustments allowed under clause 2.2.1 of the EDB IMs, NCL is of the opinion that the proposed adjustment amounting to \$793,000 should not be allowed.

2.3 VECTOR

In July 2011, NCL submitted its review of Vector's Independent Engineer's Report on the asset value adjustments including the additional information provided by Vector which was taken into consideration by the Commission in its draft decisions in relation to the resetting of the 2010 to 2015 DPPs for the EDBs. Further to this process, the Commission issued a letter on 2 September 2011 indicating the need for EDBs to potentially amend its submission with regards to the information required to undertake the asset adjustment process, as well as issued a Guidance that explains how to correct for the types of errors referred to in the aforementioned letter.

In response to the Commission's letter dated 2 September 2011, Vector has resubmitted their response to the Commission's Information Request which included the additional discussion on the following adjustments:

1. Business district multiplier for cables; and

2. Intangible assets.

The succeeding subsections present NCL's review of the additional information submitted by Vector.

2.3.1 Business District Multiplier for Cables

Vector has implemented the business district multiplier category by grouping cables into categories based on the road classifications of local councils and Transit New Zealand. These categories were: central business district, business district, urban and no multiplier. In response to the Commission's letter dated 2 September 2011, Vector submitted additional information in relation to the subcategory of urban multiplier.

The Guidance issued by the Commission discussed using post 2004 costs to support an amended 2004 multiplier value which is relevant to the proposed adjustment of Vector. The Guidance states that:

"An EDB may adjust the application of multipliers in respect of their 2004 ODV by amending the multiplier value to a value within the ranges stated in clause 2.2.1(2)(d) of the EDB IMs. Where new cost information has become available since the 2004 ODV to support amended multiplier values this information must only be used to the extent that it provides further insight into 2004 costs (refer clauses 2.2.1(2)(d) and 2.2.1(4) of the EDB IMs and paragraphs E2.17 to E2.22 of the Reasons Paper).

The Commission considers that in the first instance, data relating to 2004 costs should be used to amend the application of multipliers. However, if more recent (i.e. post 2004) cost information is sought to be used then the independent engineer must determine:

- i. whether this is appropriate; and*
- ii. if used, how the effects of factors that do not provide insight into 2004 costs (such as increases in commodity prices and the effects of inflation since 2004) should be removed.*

If an EDB has incorrectly applied clause 2.2.1(2)(d) or 2.2.1(4) then its response to the Notice must be amended and resubmitted with the necessary certification, audit and an Independent Engineer's report."

From the submission of Vector, it is worth highlighting that the previous Independent Engineer's Report to a certain extent contradicts the latest submission as highlighted below:

From Vector's Original Report:

"Vector reapplied the same 2004 ODV multipliers for the modified "urban" and "business district" categories. Cost justifications based on tendered projects and contractor rates in the 2004 ODV are considered appropriate."

From Vector's Latest Report:

"We have identified that the multiplier level adopted in 2004 had a limited amount of analytical support due to limited available data. We have therefore utilised post 2004 data to verify the level of this multiplier."

The above contradiction places some doubt on the level of confidence in the project values used as the bases in the 2004 ODV. Such inconsistency however may not play a role in deciding the appropriateness of the proposed amendment if the latest submission from Vector is viewed as being a correction of the previous submission.

Another point worth noting in Vector's submission, specifically in relation to the proposed multiplier level adjustment, is the following statement from Vector:

"The timeframe available to us under the Commission's Notices to amend and resubmit our valuation has been limited and, as a result, we have not had been able to investigate as full a range of projects to the level of detail that we would like or would normally use to support a valuation of this nature."

From the above, although Vector has indicated that they were not able to fully investigate projects to the level of detail they would normally use, NCL notes that Vector provided all the required information for compliance purposes and that the independent engineer approved of the proposed multiplier level adjustment. From this it is assumed that the independent engineer agrees with the statement from Vector that the 2004 ODV based values used previously were inadequate and that it is prudent to use post 2004 ODV values in support of the multiplier levels in question.

The only remaining question therefore is the matter of the level of confidence in the new multiplier levels. Vector has stated that they have adopted a conservative approach in specifying the new level of multipliers to compensate in some ways for the uncertainties that exist. There is no specific comment from the independent engineer in this regard; however, the independent engineer did approve the overall submission of Vector and therefore it is assumed that the independent engineer agrees with the statements made by Vector in relation to the appropriateness of the overall result and relevance to the valuation.

In conclusion, and based on the certification from the independent engineer in support of the information provided by Vector, NCL is of the view that the submission from Vector in relation to the urban multiplier level adjustment is in compliance with the requirements set out by the Commission.

2.3.2 Intangible Assets

Vector has proposed the inclusion of \$7.174 million of intangible assets but failed to provide any further information on the details of such assets. The EDB IMs specifies that the EDBs may include in their regulatory asset base intangible assets that are identifiable non-monetary assets. The EDB IMs' definition of an identifiable non-monetary asset is consistent with the meaning under the generally accepted accounting practice in New Zealand (GAAP), and excludes goodwill.

It is difficult to assess, given the limited information provided, that the assets proposed by Vector are identifiable non-monetary assets although they have indicated that the adjustment identified was made in accordance with NZ IAS 38 and reviewed by a qualified accountant. Vector has also indicated in their submission that this proposed adjustment was not reviewed by the independent engineer.

It is recognised that the value of the proposed inclusion has been established in accordance with NZ IAS 38 as part of a financial audit. However, it is clearly stated in the Commission's Information Request that should an EDB elect to undertake asset adjustments, this should form part of the written engineer's report and should comply with the requirements specified in

Schedule C. Furthermore, Schedule C states that the Independent Engineer's Report must include signed statement by the engineer that where values under GAAP have been relied on, those values have been supplied or reviewed by an appropriately qualified party.

In response to the discussions with Vector in relation to their submission, Vector provided supplemental information which included a table presenting a description of the intangible assets which they have proposed to be included in the regulatory asset base. Vector has indicated that the proposed intangible assets for inclusion are items meeting the recognition criteria for intangible assets and were valued on a cost to re-create basis at an amount of \$7.302 million, and then adjusted by consumer price index (CPI) resulting to an amount of \$7.174 million as at 2004. The proposed intangible assets include standards, plans, model and contracts acquired from United Networks Limited (UNL), as well as internally generated assets such as cost and pricing models and project crossroads which make up approximately \$0.950 million of the \$7.302 million.

NCL notes that as per clause 2.2.1 (4) of the EDB IMs, where an ODV valuation is not applicable to an 'included' asset, such asset would fall to be valued under the Electricity Information Disclosure Requirements 2004, at the value that resulted, or, for an omitted asset, would have resulted, from application of those requirements as of the day on which the asset was first commissioned after the disclosure year 2004. The Electricity Information Disclosure Requirements 2004 require that the Statement of Financial Position, which incorporates the disclosure of intangible assets as non-system fixed assets, is to be prepared in accordance with GAAP, and the relevant financial reporting standard under GAAP is NZ IAS 38.

In subsequent submissions, Vector also provided a certification from KPMG on the treatment of Vector's intangible assets. In the certification, KPMG has indicated that they consider only \$6 million out of the \$7.174 million to be intangible assets based on the recognition criteria of IAS 38. In relation to Vector's approach of valuing the assets on a cost to re-create basis, KPMG has also indicated that given that the intangible assets were acquired from UNL in a business combination, then the cost of the asset should be the fair value. KPMG further indicated that if an active market does not exist, other techniques such as the cost to replace (or cost to re-create) can be employed.

Other issues were identified following discussions in relation to Vector's supplementary submissions. Such issues include confirmation that either the values have not been taken up in the values of other assets allocated to the acquisition price; or that the costs have not been already disclosed as operational expenditure under previous electricity information disclosures. Vector has confirmed that the values in relation to acquired intangible assets have not been taken up in the values of other assets allocated to the acquisition price; however, has not provided its confirmation that the costs for internally generated assets have not been already disclosed as operational expenditure under previous electricity information disclosures.

Given that Vector has only provided a certification for \$6 million out of the \$7.174 million, then NCL is of the opinion that only the amount of \$6 million complies with the requirements of Schedule C of the Commission's Information Request. NCL therefore recommends that only \$6 million be allowed to be included in Vector's regulatory asset base. It is however worth noting that NCL's recommendation was based on information available at the time of the submission of this report, and that the issue on Vector's internally generated assets remains unresolved.

2.4 WELLINGTON ELECTRICITY

In July 2011, NCL submitted its review of Wellington Electricity's Independent Engineer's Report on the asset value adjustments including the additional information provided by Wellington Electricity which was taken into consideration by the Commission in its draft decisions in relation to the resetting of the 2010 to 2015 DPPs for the EDBs. Further to this process, the Commission issued a letter on 2 September 2011 indicating the need for EDBs to potentially amend its submission with regards to the information required to undertake the asset adjustment process.

Wellington Electricity has submitted a revised Independent Engineer's Report including relevant attachments, as well as a letter discussing the submission, in response to the Commission's letter dated 2 September 2011. The resubmission primarily discussed the following adjustments:

1. Post 2004 costs and single project costs used to support amended 2004 multiplier values;
2. Intellectual property; and
3. Transfer of asset in service from work in progress.

The succeeding subsections present NCL's review of the information submitted by Wellington Electricity.

2.4.1 Post 2004 Costs and Single Project Costs Used to Support Amended 2004 Multiplier Values

Wellington Electricity's independent engineer provided sufficient explanation as to the use of post 2004 costs (coupled with indexing) as well as the use of single project costs (as indicated by the independent engineer, their usual practice is to also compare with other information sources i.e. project costing from other sources). The additional information also provided a clear indication as to the extent of professional judgment exercised by the independent engineer in order to arrive at the proposed value adjustments.

2.4.2 Intellectual Property

As indicated in Section 2.3.2 of this report, EDBs may include in their regulatory asset base intangible assets that are identifiable non-monetary assets.

Wellington Electricity has indicated that their proposed adjustment includes intellectual property in relation to costs of database property records, technical documents and field data information. It is difficult to assess, given the limited information provided, that the assets proposed by Wellington Electricity are identifiable non-monetary assets. However, it is noted that it was indicated in the Independent Engineer's Report that the proposed intellectual property adjustment was made in accordance with GAAP and was included in the EDB's submitted Schedule A4 which formed part of the schedules audited by Deloitte (Deloitte's Independent Assurance Report dated 27 May 2011). The independent engineer has indicated that they have relied on Wellington Electricity and Deloitte for the values in relation to intellectual property but while this is the case, it is also worth noting that it has also been indicated that the intellectual property was also detailed in a fair value report prepared by Sinclair Knight Merz and PricewaterhouseCoopers at the time that the Wellington Electricity distribution network was acquired from Vector in 2008. Wellington Electricity has confirmed that only the intangible assets acquired from Vector in 2008 are currently being proposed for

inclusion. Moreover, Wellington Electricity has confirmed that the proposed values have not also been taken up in the value of other assets allocated to the acquisition price.

Given the above, NCL recommends that such adjustment amounting to \$4.915 million be allowed.

2.4.3 Transfer of Asset in Service from Work in Progress

As per clause 2.2.11 of the EDB IMs, the value of commissioned assets is the cost of the asset to an EDB determined by applying GAAP to the asset on its commissioning date. Furthermore, clause 2.2.11 (4) (b) of the EDB IMs states that revenue derived in relation to works under construction that is not included in regulatory income or preceding regulatory information disclosure requirements, reduces the cost of an asset by the amount of the revenue where such reduction is not otherwise made under GAAP.

Wellington Electricity has proposed the inclusion of \$15.2 million relating to capital expenditure on assets that have been completed or commissioned but has not been transferred to the regulatory asset register. According to Wellington Electricity, they have determined the asset value for the work in progress based on data extracted from their SAP system. They have further indicated that the adjustment was made in accordance with GAAP and is a matter of financial accounting judgment.

We note that information has been provided in Appendix G of the Independent Engineer's Report; however, it is our view that the information is insufficient to allow a reader of the report to understand the proposed adjustment which is a requirement as per Schedule C 2 (d) of the Commission's Information Request. NCL is of the view that such adjustment should have been reviewed in greater detail by the independent engineer e.g. confirming that these assets were indeed commissioned and included correctly in the regulatory asset base in the year they were commissioned; clarifying how the adjustment relates to Wellington Electricity's 2009 disclosed assets and how the adjustment was subsequently identified; how the information from the SAP system was reconciled with actual assets commissioned over the relevant period; and that the other necessary minimum information required in relation to this adjustment was provided.

In response to the above issues, and after subsequent discussions among the Commission, Wellington Electricity and NCL, Wellington Electricity has indicated that the proposed adjustment was not included in their 2009 disclosed assets as the adjustment was identified during the transition process following the sale of the business by Vector and for which Wellington Electricity assumed operational control. Wellington Electricity further indicated that any revenue received from the capital contributions have been disclosed as "revenue" under the information disclosure requirements. Furthermore, Wellington Electricity engaged SKM to address the other outstanding matters and has consequently submitted an addendum to the Independent Engineer's Report. NCL notes that SKM's report has confirmed that the assets contained in the adjustment in relation to the transfer of assets from work in progress were commissioned prior to 31 March 2009 as well as has explained the process employed to confirm the commissioning dates and the arithmetical accuracy of the proposed adjustment.

From the above, NCL is of the opinion that the proposed adjustment complies with the minimum information requirements and therefore recommends that such proposed adjustment be allowed.

**APPENDIX A: SUMMARY TABLES FOR PROPOSED ASSET
ADJUSTMENT VALUES**

EDB	Summary of Asset Adjustments (in \$000)							
	2004	NCL Proposed Adjustment	Recommended 2004	2005*	2006*	2007*	2008*	2009*
Alpine	5,855	-	5,855	-	-	-	-	354
Aurora	9,047	-	9,047	(7,915)	3,120	-	(3,341)	-
Eastland	2,257	-	2,257	-	-	-	-	-
Horizon Energy	13,794	-	13,794	-	-	-	-	-
NEL	3,129	-	3,129	-	-	-	-	-
Network Tasman	2,354	-	2,354	3	261	153	288	195
OJV	17,733	(793)	16,940	-	-	-	-	-
Powerco	63,115	-	63,115	-	-	-	-	-
TLC	20,960	-	20,960	14,263	919	592	886	2,058
Top Energy	4,090	-	4,090	-	-	-	-	-
Unison	11,810	-	11,810	-	-	-	-	-
Vector	118,531	(1,174)	117,357	-	-	-	-	-
Wellington Electricity	39,466	-	39,466	-	-	-	-	20,149

* NCL proposes no adjustment to values under this year.

The table above is a summary of NCL's proposed asset adjustment values for all the EDBs who have elected to undertake an asset adjustment process. The proposed values are the outcome from the reviews undertaken by NCL for the Commission in relation to the EDBs' Independent Engineers' reports and subsequent additional information provided. Details of the proposed values as summarised above are provided in the subsequent tables.

The tables are presented in the following order:

1. Alpine;
2. Aurora;
3. Eastland;
4. Horizon Energy;
5. NEL;
6. Network Tasman;
7. OJV;
8. Powerco;
9. TLC;
10. Top Energy;
11. Unison;
12. Vector; and
13. Wellington Electricity.

ALPINE							
Asset adjustment process - adjustments (in \$000)		2004	2005	2006	2007	2008	2009
Include load control relays		-	-	-	-	-	354
Correct asset register errors	Overhead and underground assets	5,552	-	-	-	-	-
Re-apply an existing or modified multiplier		167	-	-	-	-	-
Re-apply optimisation or EV tests		136	-	-	-	-	-
Total Adjustments		5,855	-	-	-	-	354
NCL Proposed Adjustments		-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)		5,855	-	-	-	-	354

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AURORA							
Asset adjustment process - adjustments (in \$000)		2004	2005	2006	2007	2008	2009
Include load control relays		-	-	-	-	-	-
Correct asset register errors	Distribution transformers with missing data	43,218	-	-	-	-	-
	Distribution substations missed	461,270	-	-	-	-	-
	Double counting of sub pole fuses	(3,158,856)	-	-	-	-	-
	Removal of 12/24MVA Tx from NEV sub	(362,182)	-	-	-	-	-
	Correction of Dunedin cable insulation type	499,125	-	-	-	-	-
	Additional HV cable due to late data entry	3,742,512	-	-	-	-	-
	Additional LV cable due to late data entry	3,182,595	-	-	-	-	-
	Additional distribution switchgear	135,990	-	-	-	-	-
	Additional distribution transformer	496,659	-	-	-	-	-
	Assets installed in 2004 but included in 2005 & 2006 additions	-	(3,040,165)	(38,620)	-	-	-
	Adjustments to 2004 ODV made in later disclosures	-	(4,874,787)	3,158,856	-	(3,340,920)	-
Re-apply an existing or modified multiplier		3,759,552	-	-	-	-	-
Re-apply optimisation or EV tests		247,191	-	-	-	-	-
Total Adjustments		9,047,074	(7,914,952)	3,120,236	-	(3,340,920)	-
Resubmitted proposed adjustments	Include load control relays	-	-	-	-	-	-
	Distribution transformers with missing data	43	-	-	-	-	-
	Distribution substations missed	461	-	-	-	-	-
	Double counting of sub pole fuses	(3,159)	-	-	-	-	-
	Removal of						

AURORA						
Asset adjustment process - adjustments (in \$000)	2004	2005	2006	2007	2008	2009
12/24MVA Tx from NEV sub	(362)	-	-	-	-	-
Correction of Dunedin cable insulation type	499	-	-	-	-	-
Additional HV cable due to late data entry	3,743	-	-	-	-	-
Additional LV cable due to late data entry	3,183	-	-	-	-	-
Additional distribution switchgear	136	-	-	-	-	-
Additional distribution transformer	497	-	-	-	-	-
Assets installed in 2004 but included in 2005 & 2006 additions	-	(3,040)	(39)	-	-	-
Adjustments to 2004 ODV made in later disclosures	-	(4,875)	3,159	-	(3,341)	-
Re-apply an existing or modified multiplier	3,760	-	-	-	-	-
Re-apply optimisation or EV tests	247	-	-	-	-	-
Total Adjustments	9,047	(7,915)	3,120	-	(3,341)	-
NCL Proposed Adjustments	-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)	9,047	(7,915)	3,120	-	(3,341)	-

EASTLAND						
Asset adjustment process - adjustments (in \$000)	2004	2005	2006	2007	2008	2009
Include load control relays	-	-	-	-	-	1,950
Correct asset register errors	400V Poles	(488)	-	-	-	-
	11kV Poles	(828)	-	-	-	-
	400V Lines	(81)	-	-	-	-
	11kV Lines	(21)	-	-	-	-
	400V Cables	(52)	-	-	-	-
	11kV Cables	(200)	-	-	-	-
	Switches	204	-	-	-	-
	Transformers	(31)	-	-	-	-
	Transformer fuses	(2)	-	-	-	-
Load control relays	-	-	-	-	-	(1,950)
Re-apply an existing or modified multiplier	3,756	-	-	-	-	-
Re-apply optimisation or EV tests	-	-	-	-	-	-
Total Adjustments	2,257	-	-	-	-	-
NCL Proposed Adjustments	-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)	2,257	-	-	-	-	-

HORIZON ENERGY							
Asset adjustment process - adjustments (in \$000)		2004	2005	2006	2007	2008	2009
Include load control relays		-	-	-	-	-	-
Correct asset register errors	Sub-transmission	641	-	-	-	-	-
	Substations	1,645	-	-	-	-	-
	Distribution	5,589	-	-	-	-	-
	Customer connections	(20)	-	-	-	-	-
	Other Assets	26	-	-	-	-	-
Re-apply an existing or modified multiplier		5,624	-	-	-	-	-
Re-apply optimisation or EV tests		289	-	-	-	-	-
Total Adjustments		13,794	-	-	-	-	-
NCL Proposed Adjustments		-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)		13,794	-	-	-	-	-

NEL						
Asset adjustment process - adjustments (in \$000)	2004	2005	2006	2007	2008	2009
Include load control relays	-	-	-	-	-	-
Correct asset register errors	-	-	-	-	-	-
Re-apply an existing or modified multiplier	3,129	-	-	-	-	-
Re-apply optimisation or EV tests	-	-	-	-	-	-
Total Adjustments	3,129	-	-	-	-	-
NCL Proposed Adjustments	-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)	3,129	-	-	-	-	-

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NETWORK TASMAN							
Asset adjustment process - adjustments (in \$000)		2004	2005	2006	2007	2008	2009
Include load control relays		-	-	-	-	-	-
Correct asset register errors	LV lines	663	-	-	-	-	-
	33kV lines	281	-	-	-	-	-
	Vested asset multiplier	-	3	199	153	272	268
	Change in treatment	-	-	-	-	16	(85)
	Error correction	-	-	62	-	-	12
Re-apply an existing or modified multiplier		819	-	-	-	-	-
Re-apply optimisation or EV tests		591	-	-	-	-	-
Total Adjustments		2,354	3	261	153	288	195
NCL Proposed Adjustments		-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)		2,354	3	261	153	288	195

OJV							
Asset adjustment process - adjustments (in \$000)		2004	2005	2006	2007	2008	2009
Include load control relays		-	-	-	-	-	-
Correct asset register errors	Dropouts at transformer sites	4,090	-	-	-	-	-
	Regulations	97	-	-	-	-	-
Re-apply an existing or modified multiplier		4,540	-	-	-	-	-
Re-apply optimisation or EV tests		-	-	-	-	-	-
Total		8,727	-	-	-	-	-
Resubmitted proposed adjustments	Include load control relays	-	-	-	-	-	-
	Zone substation transformers *	793	-	-	-	-	-
	Dropouts at transformer sites	3,958	-	-	-	-	-
	Recloser date correction	(1,425)	-	-	-	-	-
	11kV/LV cables, regulators, kiness, ICPs, MDIs	680	-	-	-	-	-
	Re-apply an existing or modified multiplier	13,727	-	-	-	-	-
	Re-apply optimisation or EV tests	-	-	-	-	-	-
Total Adjustments		17,733	-	-	-	-	-
NCL Proposed Adjustments		(793)	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)		16,940	-	-	-	-	-

* Please note that the Independent Engineer's Report dated 1 Nov 2011 excludes the proposed adjustment for zone substation transformers. The aforementioned proposed adjustment is discussed in a separate report dated 12 June 2012 authored by SKM.

POWERCO							
Asset adjustment process - adjustments (in \$000)		2004	2005	2006	2007	2008	2009
Include load control relays		-	-	-	-	-	-
Correct asset register errors	Correcting road levels	1,792	-	-	-	-	-
	Cable in carriageway allowance	700	-	-	-	-	-
	Streetlight point of connection	2,098	-	-	-	-	-
	Voltage regulators	972	-	-	-	-	-
	Distribution transformers	2,336	-	-	-	-	-
	Link pillars	(5,530)	-	-	-	-	-
	Distribution substations	(494)	-	-	-	-	-
	High voltage service lines	1,016	-	-	-	-	-
Re-apply an existing or modified multiplier		58,141	-	-	-	-	-
Re-apply optimisation or EV tests		2,084	-	-	-	-	-
Total Adjustments		63,115	-	-	-	-	-
NCL Proposed Adjustments		-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)		63,115	-	-	-	-	-

TLC							
Asset adjustment process - adjustments (in \$000)		2004	2005	2006	2007	2008	2009
Include load control relays		-	-	-	-	-	1,890
Correct asset register errors	33kV lines and cables	(125)	-	-	-	-	-
	11kV lines and cables	1,486	-	-	-	-	-
	LV lines and cables	709					
	Other	632					
	Found assets		9,468				
	Decommissioned		(1)		(4)	(6)	(43)
	New and vested		6,723	5,647	5,633	10,111	10,399
Re-apply an existing or modified multiplier		16,549	-	-	-	-	-
Re-apply optimisation or EV tests		-	-	-	-	-	-
Total		19,251	16,190	5,647	5,629	10,105	12,246
Resubmitted proposed adjustments	Include load control relays	-	-	-	-	-	2,021
	33kV lines and cables	(619)	-	-	-	-	-
	11kV lines and cables	4,283	-	-	-	-	-
	LV lines and cables	1,659					
	Other	341					
	Found assets		9,468				
	Decommissioned		(1)		(4)	(6)	(45)
	New and vested		4,796	919	596	892	82
	Re-apply an existing or modified multiplier	14,860	-	-	-	-	-
	Re-apply optimisation or EV tests	436	-	-	-	-	-
Total Adjustments		20,960	14,263	919	592	886	2,058
NCL Proposed Adjustments		-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)		20,960	14,263	919	592	886	2,058

TOP ENERGY							
Asset adjustment process - adjustments (in \$000)		2004	2005	2006	2007	2008	2009
Include load control relays		-	-	-	-	-	-
Correct asset register errors	Include streetlights and cables	173	-	-	-	-	-
	Correct asset ages	2,785	-	-	-	-	-
Re-apply an existing or modified multiplier		467	-	-	-	-	-
Re-apply optimisation or EV tests		665	-	-	-	-	-
Total Adjustments		4,090	-	-	-	-	-
NCL Proposed Adjustments		-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)		4,090	-	-	-	-	-

UNISON						
Asset adjustment process - adjustments (in \$000)	2004	2005	2006	2007	2008	2009
Include load control relays	-	-	-	-	-	-
Correct asset register errors	-	-	-	-	-	-
Re-apply an existing or modified multiplier	11,810	-	-	-	-	-
Re-apply optimisation or EV tests	-	-	-	-	-	-
Total Adjustments	11,810	-	-	-	-	-
NCL Proposed Adjustments	-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)	11,810	-	-	-	-	-

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VECTOR							
Asset adjustment process - adjustments (in \$000)		2004	2005	2006	2007	2008	2009
Include load control relays		-	-	-	-	-	-
Correct asset register errors	Correct road classifications of LV cables	4,636	-	-	-	-	-
	Correct remaining life calculation	1,314	-	-	-	-	-
Re-apply an existing or modified multiplier		43,408	-	-	-	-	-
Re-apply optimisation or EV tests		-	-	-	-	-	-
Total		49,358	-	-	-	-	-
Resubmitted Proposed Adjustments	Include load control relays	-	-	-	-	-	-
	Correct road classifications of LV cables	4,636	-	-	-	-	-
	Correct remaining life calculation	1,314	-	-	-	-	-
	Intangible assets (excluding goodwill)*	7,174	-	-	-	-	-
	Re-apply an existing or modified multiplier	105,407	-	-	-	-	-
	Re-apply optimisation or EV tests	-	-	-	-	-	-
Total Adjustments		118,531	-	-	-	-	-
NCL Proposed Adjustments *		(1,174)	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)		117,357	-	-	-	-	-

* Awaiting the reply from the EDB in relation to intangible assets

WELLINGTON ELECTRICITY							
Asset adjustment process - adjustments (in \$000)		2004	2005	2006	2007	2008	2009
Include load control relays		-	-	-	-	-	-
Correct asset register errors	Missing substation assets	373					
	Missing termination assets	708					
	Depreciation correction	743					
	Intellectual property						4,915
	Transfer of assets in service from WIP						15,234
Re-apply an existing or modified multiplier		36,089					
Re-apply optimisation or EV tests		1,553					
Total Adjustments		39,466	-	-	-	-	20,149
NCL Proposed Adjustments		-	-	-	-	-	-
Total Adjustments (net of NCL proposed adjustments)		39,466	-	-	-	-	20,149

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APPENDIX B: OJV COMPLIANCE TO INFORMATION REQUIREMENTS

OJV – Schedule C General Requirements

SCHEDULE C INFORMATION REQUIREMENTS	COMPLIANCE		NCL COMMENTS
	YES	NO	
1. The report must be completed by an 'engineer' as defined in clause 1.1.4 of the EDB IMs	✓		
2. The report must:			
a. be in writing and accessible in electronic format;	✓		
b. include a copy of the written instructions provided to the engineer by the EDB;	✓		
c. include a table summarising the various asset value adjustments and corresponding to Schedule A4 of the Information Disclosure Notice Templates;	✓		
d. provide the minimum information for each category of asset adjustment outlined in Table 1.	See Schedule C Table 1 Review below.		
e. include a signed statement by the engineer.	✓		

OJV – Schedule C Table 1 Requirements

CATEGORY OF ADJUSTMENT ⁶	DESIGNATED ASSET TYPE	TABLE 1 INFORMATION REQUIREMENTS	COMPLIANCE		NCL COMMENTS
			YES	NO	
1. Correct Asset Register Errors	Included, Excluded	<ul style="list-style-type: none"> Description and value of the asset 	✓		
	Value modified	<ul style="list-style-type: none"> Description and type of error 	✓		
		<ul style="list-style-type: none"> Value of each asset 	✓		Although the value for each asset was not provided, NCL notes that values per asset category were provided.
		<ul style="list-style-type: none"> Calculation of relevant adjustment 	✓		
		<ul style="list-style-type: none"> Resultant modified value 	✓		
2. Re-apply existing multiplier	Value modified	<ul style="list-style-type: none"> Description and ODV valuation for each asset 	✓		Although the multiplier originally applied was indicated in the Engineer's Report, it does not present the 2004 ODV valuation for all the assets proposed to be adjusted. However, the Engineer's report provides the values on an asset category or aggregated bases.
		<ul style="list-style-type: none"> Description of the more accurate information (including supporting facts where relevant) 	✓		
		<ul style="list-style-type: none"> Calculation to the relevant modification to the ODV and the resultant 'modified value' at 2004 ODV value 	✓		
1. Re-apply a modified multiplier	Value modified	<ul style="list-style-type: none"> Description and ODV valuation for each asset 	✓		Although the multiplier originally applied was indicated in the Engineer's Report, it does not present the 2004 ODV valuation for all the assets proposed to be adjusted. However, the Engineer's report provides the values on an asset category or aggregated bases.
		<ul style="list-style-type: none"> Specification of the alternative 	✓		

⁶ The categories of adjustments presented in the table include only the categories where adjustments have been proposed by the EDB.

OJV – Schedule C Table 1 Requirements

CATEGORY OF ADJUSTMENT ⁶	DESIGNATED ASSET TYPE	TABLE 1 INFORMATION REQUIREMENTS	COMPLIANCE		NCL COMMENTS
			YES	NO	
		multiplier and the reason for selecting the value within the range			
		<ul style="list-style-type: none"> Details of supporting facts where relevant to support the reason 	✓		Even though OJV complies, NCL is of the view that for the requested substantial asset adjustment for the rugged multiplier, more support could have been provided.
		<ul style="list-style-type: none"> Calculation to the relevant modification to the ODV and the resultant 'modified value' at 2004 ODV value 	✓		