

Proposed amendments to input methodologies for Transpower

Consultation paper

Amendments proposed to be made under s 52X of the Commerce Act 1986 to the input methodologies for electricity lines services supplied by Transpower New Zealand Limited.

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Chapter 1: Introduction

Purpose of this paper

- 1.1 The purpose of this paper is to consult with interested persons on proposed amendments to the input methodologies for electricity lines services supplied by Transpower New Zealand Limited.

Determinations affected by the amendments

- 1.2 We are consulting on proposed amendments to the following determinations.
- 1.2.1 Transpower Input Methodologies Determination [2012] NZCC 17.
 - 1.2.2 Transpower Capital Expenditure Input Methodology Determination [2012] NZCC 2.
- 1.3 The amendments relate to changes to input methodologies we consider are necessary or appropriate to make prior to setting Transpower's individual price-quality path for the second regulatory control period, to commence on 1 April 2015.
- 1.4 Many of these amendments were signalled in the recent consultation paper on Transpower's individual price-quality path for 2015-2020. This paper expands on this by presenting proposed changes to the input methodologies for consultation.
- 1.5 This paper also consults on a proposed approach to allow depreciation in the year of commissioning. This follows on from our initial discussion of this issue in our March 2014 consultation paper.¹
- 1.6 We intend to reach a final decision on all amendments to the Transpower input methodologies in August 2014. This will include the amendments covered in this paper, as well as those covered in our March 2014 consultation paper.

Overview of proposed amendments

- 1.7 This paper seeks submissions on proposed amendments to Transpower's individual price quality path. These are set out below.
- 1.7.1 Terminology change in order to align reconsideration of the price-quality path with the new quality standards.
 - 1.7.2 Adjusting the base capex allowance for 'listed projects'.

¹ Commerce Commission, 'Proposed amendments to input methodologies for Transpower: Consultation paper', 11 March 2014

- 1.7.3 Allowing for recovery of forecast major capex that is actually opex incurred during the regulatory period.
 - 1.7.4 Allowing for recovery of additional net opex incurred as a result of a catastrophic event.
 - 1.7.5 Adjustments to the definition of forecast CPI for the purposes of setting capex and opex allowances.
 - 1.7.6 Updating the definition of 'related party' to exclude parties that are related to Transpower solely through the Crown's ownership of Transpower.
 - 1.7.7 Allowing for depreciation in the year of commissioning.
- 1.8 The specific amendments are set out in chapter 2, as well as in the accompanying mark-up of the Transpower input methodologies.

2. Proposed changes to the input methodologies to implement the individual price-quality path decision

- 2.1 This chapter discusses the proposed amendments to the Transpower input methodologies. The proposed amendments to the determination are also set out in the accompanying mark-up of the Transpower input methodologies.

Terminology change in order to align reconsideration of the price-quality path with the new quality standards

- 2.2 We propose to amend the input methodologies to update the provisions dealing with reconsideration of the price-quality path following a catastrophic event. Previously the Transpower IM reconsideration provisions focused on the quality targets set in the 2010 IPP. The Capex IM introduced the concept of revenue-linked grid output measures which underpin Transpower's quality standards proposed to apply from the second regulatory period. A terminology change is necessary to align the catastrophic event reconsideration provisions with the Capex IM framework which sits behind the quality standards proposed for Transpower for the second regulatory period.
- 2.3 To implement this change we propose to update the clauses governing when the price-quality path may be reconsidered following a catastrophic event with reference to the new revenue-linked grid output measures specified in the Capex IM. The change is principally given effect through the following changes to clause 3.7.1(c)(i)

3.7.1 Catastrophic event

Catastrophic event means an event-

...

(c) in respect of which-

- (i) action required to rectify its adverse consequences cannot be delayed until a future **regulatory period** without the **grid outputs** associated with the **revenue-linked grid output measures** being outside the range specified by the relevant **cap** or **collar** in the remaining **disclosure years** of the **regulatory period**;

- 2.4 We also propose deleting the defined term "quality targets", and substituting the following new definitions in clause 1.1.4(2):

revenue-linked grid output measure has the same meaning as defined in the **Capex IM**

cap has the same meaning as defined in the **Capex IM**

collar has the same meaning as defined in the **Capex IM**

grid output has the same meaning as defined in the **Capex IM**

grid output target has the same meaning as defined in the **Capex IM**

grid output incentive rate has the same meaning as defined in the **Capex IM**

2.5 We also propose to include a definition of Capex IM determination as follows:

Capex IM means the *Transpower Capital Expenditure Input Methodology* [2012] NZCC 2

2.6 Additional modifications would be made to clauses 3.7.4(3) and 3.7.5(1), (2)(b), and (3) to update the references from the former 'quality targets'. In clauses 3.7.4(3) and 3.7.5(1), the former references to 'quality targets' should be updated to refer to the '**grid output targets, caps, collars and grid output incentive rates** associated with **revenue-linked grid output measures**'. Further:

2.6.1 clause 3.7.5(2)(b) is updated as follows:

(2) The **Commission** must not amend the-

...

(b) **grid output targets, caps, collars or grid output incentive rates** associated with the **revenue-linked grid output measures** more than reasonably necessary to take into account any necessary changes in quality;

2.6.2 the former references to 'quality targets' in clause 3.7.5(3) should be updated to refer to the '**grid output targets** associated with **revenue-linked grid output measures**'.

Adjusting the base capex allowance for 'listed projects'

2.7 We propose to amend the input methodologies to allow for the revenue impacts of the base capex 'listed project' framework proposed for the individual price-quality path to flow through to the forecast MAR as part of the yearly revenue update process.

2.8 To implement this change we propose to amend clause 3.7.4(5) 3.7.5(2)(g) to include adjustments to the price path following approval of any of the listed projects set out in the IPP determination, as follows:

3.7.4 When price-quality paths may be reconsidered

...

(5) The **Commission** will reconsider by 30 November, in each year of a **regulatory period**, subject to subclause (6), save the last, the **IPP** in

respect of the remaining **disclosure years** commencing in the **regulatory period** to take account of-

- (a) the revenue impact of major capex approved by the **Commission**;
- (b) the revenue impact of the **capital expenditure** of any **listed project** approved for inclusion in the **base capex allowance** by the **Commission** in accordance with the processes set out in an **IPP determination**; and
- (c) an EV adjustment,

on **forecast MAR**.

3.7.5 Amending price-quality path after reconsideration

...

(2) The **Commission** must not amend the-

...

- (g) the amendment required to **forecast MAR** to account for-
 - (i) the revenue impact of major capex approved by the **Commission**; or
 - (ii) the revenue impact of the **base capex allowance** of any **listed project** approved by the **Commission**; or
 - (iii) an EV adjustment,

as the case may be.

2.9 In addition, we propose the following new definitions are added to clause 1.1.4(2):

base capex allowance has the same meaning as defined in the **Capex IM**;

listed project has the same meaning as defined in an **IPP determination**;

Treating forecast major capex as actual opex during the regulatory period

2.10 We propose to amend the input methodologies to provide for Transpower to recover its opex incurred in respect of approved major capex projects as recoverable costs.

2.11 To implement this we propose that a new recoverable cost term is added to clause 3.1.3(1), as follows:

- (d) any operating costs incurred as part of a **major capex project**, subject to the requirements in subclause (3).

- 2.12 The new recoverable cost would be subject to the same criteria as generally apply to transmission alternative costs, which are set out in clause 3.1.3(3). We therefore also propose to consequently update clause 3.1.3(3) to apply to the new recoverable cost term in 3.1.3(1)(d).
- 2.13 A consequential change is also proposed to move the requirements set out in subclause (3) that relate only to transmission alternative operating costs to the specified recoverable cost term for transmission alternative costs set out in clause 3.1.3(1)(c).

Additional net opex incurred as a result of a catastrophic event

- 2.14 We propose to amend the input methodologies to allow Transpower to seek recovery of any prudent additional net opex costs it incurs in the period between the time of a catastrophic event and a reconsidered individual price-quality path taking effect.
- 2.15 To implement this we propose to add a new recoverable cost to clause 3.1.3(1) as follows:
- (e) following a reconsideration and amendment of the **IPP** under clauses 3.7.4(2)(a) and 3.7.5(1), the prudent net additional operating costs, incurred in excess of those provided in an **IPP determination** in responding to a **catastrophic event** until the effective date of the amended **IPP**, as determined by the **Commission** in the amended **IPP determination**

Forecast CPI for the purposes of setting capex and opex allowances

- 2.16 We propose to amend the definition of ‘forecast CPI’ in the Capex IM to reflect changes to the Reserve Bank of New Zealand’s (Reserve Bank’s) Policy Targets Agreement which would be used, among other things, in setting the base capex allowance for RCP2.
- 2.17 To implement this we propose amending the definition of “forecast CPI” in the Capex IM by omitting current paragraph (b) and replacing it as follows:
- forecast CPI** means **CPI**, unless **CPI** does not apply to the period in question, in which case it means the most recent **CPI** extended by-
- (a) in the case of a quarter for which a forecast of the annual percent change in the headline **CPI** contained in the current Monetary Policy Statement issued by the Reserve Bank of New Zealand has been made, that forecast; and
 - (b) in respect of later quarters, the forecast last applying under subparagraph (a) adjusted such that an equal increment or decrement made to that forecast for each of the following three years results in the forecast for the last of those years being equal to

the target midpoint for the change in headline **CPI** set out in the Monetary Policy Statement referred to in subparagraph (a);

Definition of ‘related party’

- 2.18 We propose to amend the definition of ‘related party’ to avoid an overreach of the application of that term in the individual price-quality path and information disclosure. As we noted in our consultation paper on Transpower’s individual price-quality path for 2015-2020, the GAAP reporting standard indirectly referred to in the existing definition has the effect of including all Government-related entities as related parties to Transpower.² This includes Transpower’s shareholder (the Crown), the arms of the Crown (ie, Government departments) and State Owned Enterprises such as Meridian Energy Limited, which is an unintended consequence.
- 2.19 To implement this we propose to update the definition of related party, and add a new defined term, “related party transaction”:

related party means-

- (a) a **person** that, in accordance with **GAAP**, is a related party to **Transpower**, other than as a result of Transpower being a Crown-owned entity; or
- (b) any part of **Transpower** that does not **supply electricity transmission services**;

related party transaction means a transaction with a related party in accordance with GAAP;

- 2.20 In addition, we propose to update clause 2.2.7(1)(h) as follows:

- (h) an asset acquired from a **related party** in a **related party transaction** other than an asset to which paragraphs (f) or (g) apply is-

Depreciation in the year of commissioning

- 2.21 We propose to amend the input methodologies to allow part year depreciation in the year of commissioning of a new asset. We sought feedback from interested persons on whether we should allow depreciation in the year of commissioning in our paper “Proposed amendments to input methodologies for Transpower:

³ Powerco, ‘Submission on proposed amendments to input methodologies – Consultation paper’ 31 March 2014; Transpower ‘Submission on proposed amendments to input methodologies – Consultation paper’ 31 March 2014; Transpower ‘Cross- Submission on proposed amendments to input methodologies – Consultation paper’ 31 March 2014; Vector, ‘Submission on proposed amendments to input methodologies – Consultation paper’ 31 March 2014.

consultation paper, 11 March 2014". We received submissions from Transpower, Powerco and Vector.³ No submissions opposed this amendment.

2.22 We proposed to implement depreciation in the year of commissioning by:

2.22.1 Allowing the depreciation formula to produce an amount of depreciation for the year in which an asset is commissioned, for all assets commissioned after the commencement of the disclosure year 2016 (corresponding with the commencement of RCP2). The first year depreciation will be pro rated for the fraction of the year that the asset is commissioned. The depreciation amount will be included in the RAB roll-forward for the asset;

2.22.2 At the commencement of disclosure year 2016, the RAB value of each asset commissioned during RCP1 shall be reduced by the difference between its GAAP value and its regulatory value, to the extent that the difference results from differences between GAAP and our regulatory asset valuation approach in the treatment of depreciation in the year of commissioning, and

2.22.3 At the commencement of disclosure year 2016, a single pseudo asset shall be established and included in the RAB, with a value at its creation being equal to the total reduction in RAB value in the previous paragraph and with the life of the pseudo asset being the average life of assets commissioned during RCP1.

2.23 The changes we propose to clauses 2.2.3 and 2.2.4 to give effect to depreciation for newly-commissioned assets are set out below. Unallocated depreciation in the year of commissioning is calculated in accordance with new subclause 2.2.4(1)(b). Depreciation allocated to electricity transmission services in the year of commissioning is calculated, in the proposed new subclause 2.2.4(2)(b), using the value of commissioned asset (allocating the value attributable to electricity transmission services in accordance with clause 2.1.1), as newly-commissioned assets do not have an opening RAB value (until the next disclosure year), and the closing RAB value already takes into account depreciation in the first year.

2.2.3 RAB roll forward

(1) Unallocated opening RAB value in respect of an asset in relation to-

(a) the **disclosure year 2012**, is its **unallocated initial RAB value**; and

³ Powerco, 'Submission on proposed amendments to input methodologies – Consultation paper' 31 March 2014; Transpower 'Submission on proposed amendments to input methodologies – Consultation paper' 31 March 2014; Transpower 'Cross- Submission on proposed amendments to input methodologies – Consultation paper' 31 March 2014; Vector, 'Submission on proposed amendments to input methodologies – Consultation paper' 31 March 2014.

- (b) a **disclosure year** thereafter, is its **unallocated closing RAB value** in the preceding **disclosure year**.
- (2) Unallocated closing RAB value means, in the case of-
- (a) a **found asset**, its **value of found asset**;
 - (b) a **disposed asset**, nil;
 - (c) a **lost asset**, nil;
 - (d) any other asset with an **unallocated opening RAB value**, the value determined in accordance with the formula-

unallocated opening RAB value - unallocated depreciation;
 - (e) an asset to which clause 2.2.7(4)(b)(i) applies, the result of the formula in paragraph (d), increased by the amount of expenditure described in clause 2.2.7(4)(b)(i) in the **disclosure year** in question; and
 - (f) any other asset having a **commissioning date** in the **disclosure year** in question, the value determined in accordance with the formula-

value of commissioned asset – unallocated depreciation.
- (3) Opening RAB value in respect of an asset is, for-
- (a) the **disclosure year** 2012, its **initial RAB value**; and
 - (b) a **disclosure year** thereafter, its **closing RAB value** in the preceding **disclosure year**.
- (4) Closing RAB value, in respect of an asset, is determined as the value allocated to **electricity transmission services** by-
- (a) adopting its **unallocated closing RAB value**; and
 - (b) applying 2.1.1 to it.

2.2.4 Depreciation

- (1) Unallocated depreciation is determined, subject to subclause (3) and clause 2.2.5, in accordance with the formula, in the case of-
- (a) an asset with an **unallocated opening RAB value** -

$[1 \div \text{remaining asset life}] \times \text{unallocated opening RAB value}$;

 and
 - (b) an asset having a **commissioning date** in the **disclosure year** in question-

$[1 \div \text{remaining asset life}] \times \text{value of commissioned asset} \times \text{the fraction of the disclosure year from the commissioning date to the last day of the disclosure year.}$

(2) Depreciation is determined, subject to subclause (3)(a), in accordance with the formula, in the case of -

(a) an asset with an **opening RAB value**-

$[1 \div \text{remaining asset life}] \times \text{opening RAB value};$ and

(b) an asset having a **commissioning date** in the **disclosure year** in question-

$[1 \div \text{remaining asset life}]$

×

value allocated to electricity transmission services by adopting the value of commissioned asset and applying clause 2.1.1 to it as if it were an asset value

×

the fraction of the disclosure year from the commissioning date to the last day of the disclosure year.

(3) For the purposes of subclauses (1) and (2)-

(a) unallocated depreciation and depreciation are nil in the case of-

(i) **land**;

(ii) an **easement** other than a **fixed life easement**; and

(iii) a **network spare** in respect of the period before which depreciation for the **network spare** in question commences under **GAAP**; and

(b) in all other cases, where an asset's **physical asset life** at the end of the **disclosure year** is nil-

(i) unallocated depreciation is the asset's **unallocated opening RAB value**; and

(ii) depreciation is the asset's **opening RAB value**.

2.24 We propose consequential amendments to the definition of 'unallocated opening RAB value', 'remaining asset life', and 'depreciation' in clause 1.1.4(2).

2.25 Transpower requested that an adjustment also be made to the value of assets commissioned during RCP1 to align their values with the GAAP treatment of depreciation insofar as depreciation in the year of commissioning was permitted under GAAP. This proposed adjustment is achieved in new clause 2.2.9(1), as follows:

2.2.9 Adjustment to asset values and establishment of RCP1 pseudo asset

- (1) Each asset with a **commissioning date** in the period commencing
- (a) on the first day of the **disclosure year** 2012; and
 - (b) ending on the last day of the **disclosure year** 2015,
- shall have its values calculated pursuant to-
- (c) clause 2.2.3(1); and
 - (d) clause 2.2.3(3),
- for the **disclosure year** 2016 adjusted by the amounts necessary to produce the value for each asset as if **depreciation** had applied for the **disclosure year** in which the asset's **commissioning date** occurred.

- 2.26 As the adjustment to asset values would alter the amount of depreciation recovered over the life of affected assets in the future, we propose to adjust for this by creating a single depreciable "pseudo asset" defined as follows:

RCP1 pseudo asset means the composite asset calculated in accordance with clause 2.2.9(2);

- 2.27 In order to ensure that the impacts of the asset adjustments are NPV-neutral, we propose the pseudo asset will have a value equal to the sum of the adjustments made to asset values and is depreciated using an asset life determined using the composite asset approach in clause 2.2.6(1)(i). The changes are set out in new clause 2.2.9(2), as follows:

- (2) The 'RCP1 pseudo asset' is a composite asset established as of the first day of the **disclosure year** 2016 with-
- (a) an **unallocated opening RAB value** equal to the sum of adjustments for all assets made under subclause (1) in respect of clause 2.2.3(1);
 - (b) an **opening RAB value** equal to the sum of all adjustments for all assets made under subclause (1) in respect of clause 2.2.3(3); and
 - (c) a physical asset life determined pursuant to clause 2.2.6(1)(i) where, for the purpose of that clause-
 - (i) the amount of each adjustment made in respect of clause 2.2.3(3) shall be considered the 'opening RAB value' for a component asset with an asset life corresponding to that of the asset adjusted; and
 - (ii) the 'disclosure year' is the **disclosure year** 2016.

3. How you can provide your views and next steps

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

How you can provide your views

- 3.2 Submissions on the proposed draft methodology are due by 5pm, Friday, 27 June 2014.

Address for responses

- 3.3 You should address your responses to:

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

- 3.4 It would be helpful to include in the subject heading 'Submission on Proposed Transpower IM Amendments May 2014'.
- 3.5 We would appreciate receiving responses in both MS Word and PDF file formats.

Requests for confidentiality

- 3.6 While we discourage requests for non-disclosure of submissions, we recognise that there may be cases where parties that make submissions wish to provide information in confidence. We offer the following guidance.
- 3.7 If it is necessary to include confidential material in a submission, the information should be clearly marked. Both confidential and public versions of the submission should be provided.
- 3.8 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.
- 3.9 We request that you provide multiple versions of your submission if it contains confidential information or if you wish for the published electronic copies to be 'locked'. This is because we intend to publish all submissions and cross-submissions on our website. Where relevant, please provide both an 'unlocked' electronic copy of your submission, and a clearly labelled 'public version'.

Next steps

- 3.10 Following receipt of submission, we intend to make final decisions on any amendments in August 2014. This will include the amendments consulted on in this paper as well as amendments in our March 2014 consultation paper.