

# **Input methodologies review decisions**

## **Report on the IM review**

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## Associated documents

Publication date	Reference	Title
20 December 2016	978-1-869455-43-9	Input methodologies review decisions: Summary paper
20 December 2016	978-1-869455-44-6	Input methodologies review decisions: Introduction and process paper
20 December 2016	978-1-869455-53-8	Input methodologies review decisions: Framework for the IM review
20 December 2016	978-1-869455-45-3	Input methodologies review decisions: Topic paper 1 – Form of control and RAB indexation for EDBs, GPBs and Transpower
20 December 2016	978-1-869455-46-0	Input methodologies review decisions: Topic paper 2 – CPP requirements
20 December 2016	978-1-869455-47-7	Input methodologies review decisions: Topic paper 3 – The future impact of emerging technologies in the energy sector
20 December 2016	978-1-869455-48-4	Input methodologies review decisions: Topic paper 4 – Cost of capital issues
20 December 2016	978-1-869455-49-1	Input methodologies review decisions: Topic paper 5 – Airports profitability assessment
20 December 2016	978-1-869455-50-7	Input methodologies review decisions: Topic paper 6 – WACC percentile for airports
20 December 2016	1178-2560	<i>Electricity Distribution Services Input Methodologies Amendments Determination 2016 [2016] NZCC 24</i>
20 December 2016	1178-2560	<i>Gas Distribution Services Input Methodologies Amendments Determination 2016 [2016] NZCC 25</i>
20 December 2016	1178-2560	<i>Gas Transmission Services Input Methodologies Amendments Determination 2016 [2016] NZCC 26</i>
20 December 2016	1178-2560	<i>Transpower Input Methodologies Amendments Determination 2016 [2016] NZCC 27</i>
20 December 2016	1178-2560	<i>Airport Services Input Methodologies Amendments Determination 2016 [2016] NZCC 28</i>
20 December 2016	1178-2560	<i>Airport Services Information Disclosure Amendments Determination 2016 [2016] NZCC 29</i>

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## CONTENTS

<b>INPUT METHODOLOGIES REVIEW DECISIONS</b> .....	<b>1</b>
CHAPTER 1: INTRODUCTION .....	1
<b>PART 1: IM DECISIONS THAT WE HAVE CHANGED</b> .....	<b>9</b>
CHAPTER 2: INTRODUCTION TO PART 1 .....	9
CHAPTER 3: COST ALLOCATION DECISIONS WE HAVE CHANGED.....	10
CHAPTER 4: ASSET VALUATION DECISIONS WE HAVE CHANGED.....	16
CHAPTER 5: TREATMENT OF TAXATION DECISIONS WE HAVE CHANGED.....	49
CHAPTER 6: COST OF CAPITAL DECISIONS WE HAVE CHANGED.....	59
CHAPTER 7: SPECIFICATION OF PRICE DECISIONS WE HAVE CHANGED.....	78
CHAPTER 8: RECONSIDERATION OF THE PRICE-QUALITY PATH DECISIONS WE HAVE CHANGED.....	103
CHAPTER 9: IRIS DECISIONS WE HAVE CHANGED.....	112
<b>PART 2: IM DECISIONS THAT WE HAVE NOT CHANGED</b> .....	<b>118</b>
CHAPTER 10: INTRODUCTION TO PART 2 .....	118
CHAPTER 11: COST ALLOCATION DECISIONS WE HAVE NOT CHANGED.....	119
CHAPTER 12: ASSET VALUATION DECISIONS WE HAVE NOT CHANGED.....	121
CHAPTER 13: TREATMENT OF TAXATION DECISIONS WE HAVE NOT CHANGED.....	130
CHAPTER 14: COST OF CAPITAL DECISIONS WE HAVE NOT CHANGED.....	131
CHAPTER 15: GAS PRICING METHODOLOGIES DECISIONS WE HAVE NOT CHANGED.....	136
CHAPTER 16: SPECIFICATION OF PRICE DECISIONS WE HAVE NOT CHANGED.....	139
CHAPTER 17: IRIS DECISIONS WE HAVE NOT CHANGED.....	142
<b>PART 3: IM DECISIONS THAT WE HAVE NOT CHANGED AND FOUND NO REASON TO CONSIDER CHANGING</b> .....	<b>148</b>
CHAPTER 18: INTRODUCTION TO PART 3 .....	148
CHAPTER 19: DECISIONS WE HAVE NOT CHANGED, AND FOUND NO REASON TO CONSIDER CHANGING .....	149
<b>ATTACHMENT A: INDEX OF PRE-REVIEW IM DECISIONS</b> .....	<b>175</b>
<b>ATTACHMENT B: NEXT CLOSEST ALTERNATIVE PROVISION</b> .....	<b>188</b>
<b>ATTACHMENT C: REOPENER PROVISION FOR LIVE-LINE WORK</b> .....	<b>189</b>
<b>ATTACHMENT D: FURTHER EXPLANATION OF THE PRICE SETTING AND WASH-UP PROCESSES UNDER A REVENUE CAP</b> .....	<b>193</b>
<b>ATTACHMENT E: TIMING AND TRANSITION PROVISIONS IN THE IM AMENDMENTS DETERMINATIONS</b> .....	<b>196</b>

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## Chapter 1: Introduction

### Purpose of this report

1. The purpose of this report is to:
  - 1.1 present the results of our review of the input methodologies (IMs) for electricity lines services, gas pipeline services and specified airport services in accordance with our decision-making framework;<sup>1</sup> and
  - 1.2 summarise our decisions on whether to change the IMs, and explain our reasons for changing or not changing them. Our decisions reflect both our findings in the key topic areas for the review and the findings of our wider effectiveness review of the IMs.

### The role of this report in presenting our decisions on the IM review

2. This report records our decisions on whether to change the pre-review IM decisions as a result of the IM review.<sup>2</sup> For those pre-review IM decisions we have changed, it explains how and why.<sup>3</sup> It also explains our reasons for not changing the pre-review IM decisions we have decided not to change as part of the IM review.
3. The framework we applied in reaching our decisions is set out in a separate paper, published alongside this report.<sup>4</sup> The framework paper explains that we have only changed the IMs where this is likely to:
  - 3.1 promote the Part 4 purpose in s 52A more effectively;
  - 3.2 promote the IM purpose in s 52R more effectively (without detrimentally affecting the promotion of the s 52A purpose); or
  - 3.3 significantly reduce compliance costs, other regulatory costs or complexity (without detrimentally affecting the promotion of the s 52A purpose).
4. This report is framed in terms of the pre-review IM decisions and whether we have decided to change them or change how they are implemented. In many cases, the report does not necessarily go down to the level of explaining the detail of the IM amendments determinations that we have also published today to give effect to the changes to our pre-review IM decisions.

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<sup>1</sup> As noted at paragraphs 24-27, the Transpower Capex IM is outside the scope of the review, there are some specific areas within the scope of review where we have not yet reached decisions, and not all areas within the scope of the review are covered by this report.

<sup>2</sup> Again, with the exceptions noted at paragraphs 24-27.

<sup>3</sup> As we discuss further below, we derived the pre-review IM decisions from our previous IM reasons papers. The set of pre-review IM decisions were given effect to through the IM determinations published prior to today.

<sup>4</sup> Commerce Commission "Input methodologies review decisions: Framework for the IM review" (20 December 2016).

5. The amendments determinations give effect to the IM review by changing the IM determinations to reflect our decisions.
6. The topic papers explain our solutions to the problems identified within each topic area. Most of those solutions involve changes to the IMs, but some involve changes to other aspects of the Part 4 regime.<sup>5</sup>
7. This report records our decisions on how we have changed our pre-review IM decisions to give effect to those solutions. For those decisions (ie, that are driven by a solution to a problem discussed in a topic paper), we generally refer back to the reasoning in the relevant topic paper rather than repeating the reasoning in this report.
8. As illustrated by Figure 1, this report also presents decisions we have reached on additional matters not covered by the topic papers.<sup>6</sup> These decisions record the results of our effectiveness review of the IMs, which was based on a review of:<sup>7</sup>
  - 8.1 stakeholder submissions on the IM review; and
  - 8.2 relevant reference material, such as the IM determinations and reasons papers, and Court judgments, as well as our own knowledge of known issues.

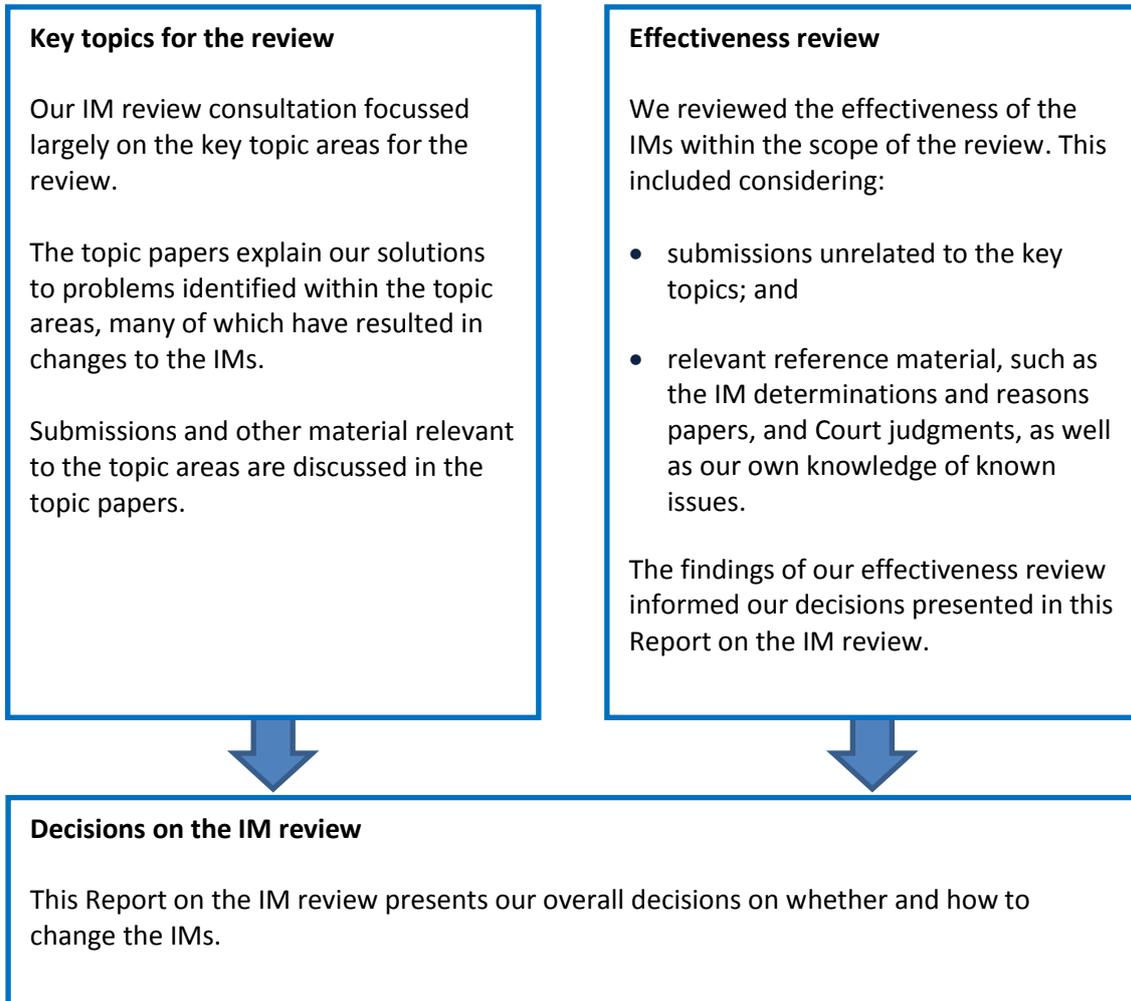
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<sup>5</sup> For example, Topic paper 5: Airports profitability assessment, explains a number of changes we have made to the information disclosure requirements for airports as part of the solution to problems identified in that topic area.

<sup>6</sup> Most of the changes in this category are minor; however, we generally provide more explanation for these decisions than those that are also discussed in a topic paper.

<sup>7</sup> Our effectiveness review process is described in more detail in the Introduction and Process paper. Commerce Commission “Input methodologies review decisions: Introduction and process” (20 December 2016).

**Figure 1: The sources of the decisions presented in this report**



9. We received a number of submissions on our draft IM determinations and revised draft IM determinations that set out marked-up drafting suggestions to fix errors or improve the drafting style or readability of the IMs.<sup>8</sup> Although we have not accepted all of these drafting suggestions, we have endeavoured to accept those which promote the high-level objectives for the review, as set out in the framework paper, and would improve the clarity and workability of provisions while not affecting their meaning, or having consequential impacts. As some of these changes are minor in nature, we have not detailed them in this report.

<sup>8</sup> We particularly acknowledge the Board of Airline Representatives NZ (**BARNZ**), Electricity Networks Association (**ENA**), the New Zealand Airports Association (**NZAA**) and Transpower for their substantial and detailed contributions.

10. As noted above, this report presents a number of changes to the IMs that were driven from our effectiveness review, rather than as solutions to problems identified within the key topics. The bulk of these changes are aimed at clarifying the rules, removing ambiguities, correcting errors, or reducing unnecessary complexity and compliance costs. We consider that, collectively, these should better promote s 52R by increasing certainty about what the rules are, as well as reducing complexity and compliance costs.
11. The framework paper sets out the types of questions we considered in reviewing the IMs, such as:<sup>9</sup>
  - 11.1 Is the policy intent behind the IM still relevant and appropriate?
  - 11.2 Is the current IM achieving that intent?
  - 11.3 Could the current IM achieve the policy intent better?
  - 11.4 Could the current IM achieve the policy intent as effectively, but in a way that better promotes s 52R or reduces complexity or compliance costs?
  - 11.5 Do changes to other IMs require any consequential changes to the IM in question for internal consistency or effectiveness reasons?
12. It also describes key economic principles that can provide guidance as to how we might best promote the Part 4 purpose.

#### **How this report presents the results of the IM review**

13. This paper presents the results of the IM review for each of the pre-review IM decisions. We consider that this is easier to follow, and more useful, than presenting the results of the review on an 'IM determination, clause-by-clause' basis.
14. Using the IM overview tables in the 2010 IMs reasons papers as a starting point, we extracted the descriptions of the pre-review IM policy and implementation decisions.<sup>10</sup> We also included descriptions of amendments made since 2010 in order to ensure that the pre-review decisions listed in this report are a complete and up-to-date description of the pre-review IM decisions.
15. We assigned each of these pre-review IM decisions a code (eg, 'CA01' for cost allocation decision number 1) to aid readers. We also use these codes when referring to pre-review IM decisions in the topic papers.

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<sup>9</sup> We have considered these questions where relevant in reviewing the IMs. We have not considered them in any particular order; nor have we ascribed any set weighting to each question. The questions provide practical tools, or lenses, that we have used to examine the IMs.

<sup>10</sup> For example, for EDB and GPB cost allocation policy and implementation decisions, refer to Commerce Commission "Input methodologies (electricity distribution and gas pipeline services): Reasons paper" (22 December 2010), p. 57-58.

16. For some areas of the IMs, extracting the pre-review IM decisions was straightforward (for instance, for those chapters of the 2010 IM reasons papers that begin with IM overview tables summarising decisions we made in that area). In other areas (such as those decisions that have been amended since 2010 and do not have summary tables), we extracted the pre-review decisions from descriptions in the text of the relevant reasons papers.<sup>11</sup>
17. In 2012, we extended our IM decisions on cost allocation, asset valuation and the treatment of taxation to also apply to default price-quality paths (**DPPs**).<sup>12</sup> Originally, our IM decisions for these matters were only specified as applicable to customised price-quality path (**CPP**) proposals, and to information disclosure (**ID**) regulation. We extended the application of those IM decisions to apply to DPPs by taking the then-existing IMs as a starting point and simplifying the components where necessary.
18. In this report, we have not referred to the 2012 extensions as amendments to the original 2010 IM decisions because the pre-review IM decisions are generally described at a level above the detail of how the decisions apply in particular regulatory instruments.<sup>13</sup>
19. Presenting the results of the IM review in terms of the pre-review IM decisions allows us to illustrate where this report presents changes to:
  - 19.1 the policy intent of a pre-review IM decision; and/or
  - 19.2 the way a pre-review decision is implemented.
20. This report presents one new decision on an existing IM matter (IM decision AV55).
21. The pre-review IM decisions are presented in the following groups:
  - 21.1 cost allocation (coded 'CA');
  - 21.2 asset valuation (coded 'AV');
  - 21.3 treatment of taxation (coded 'TX');
  - 21.4 cost of capital (coded 'CC');

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<sup>11</sup> This is also the case for the CPP requirements IMs. How we have dealt with the pre-review IM decisions for CPP requirements IMs is explained at paragraph 27.

<sup>12</sup> Commerce Commission "Specification and Amendment of Input Methodologies as Applicable to Default Price-Quality Paths: Reasons paper" (28 September 2012), available at: <http://www.comcom.govt.nz/dmsdocument/9506>.

<sup>13</sup> Where we have changed a pre-review decision that has particular relevance for a specific regulatory instrument (eg, ID, DPP, CPP or IPP), we have noted this in our explanation of the change.

- 21.5 gas pricing methodologies (coded 'GP');
  - 21.6 specification of price (coded 'SP');
  - 21.7 reconsideration of the price-quality path (coded 'RP');
  - 21.8 amalgamations (coded 'AM');
  - 21.9 incremental rolling incentive scheme (**IRIS**) (coded 'IR'); and
  - 21.10 other regulatory rules and processes (coded 'RR').
22. There is a group of pre-review IM decisions for CPP requirements (which we have coded 'CP'). These are covered by Topic paper 2: CPP requirements, rather than in this report.
23. The location of each of these pre-review decisions is summarised in Attachment A of this report.

*Scope of the IM review*

24. As set out in the Notice of intention, the IM review included all IMs as amended to date (including as a result of fast track decisions already made as part of the IM review), except the Transpower Capex IM.<sup>14</sup>

*Scope of our decisions package for the IM review*

25. Our decisions package presents decisions on all IMs within the scope of the review except the IMs covering:<sup>15</sup>
- 25.1 the CPP information requirements for gas;
  - 25.2 related party transactions provisions; and
  - 25.3 the Transpower IRIS.
26. While these areas are still within the scope of the IM review, we have not yet reached decisions on them. Our timeframes for reaching decisions on these areas are set out in the Introduction and process paper.<sup>16</sup>

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<sup>14</sup> Commerce Commission "Amended notice of intention: Input methodologies review" (14 September 2016).

<sup>15</sup> As discussed in "Commerce Commission "Input methodologies review decisions: Introduction and process paper (20 December 2016).

<sup>16</sup> Commerce Commission "Input methodologies review decisions: Introduction and Process paper" (20 December 2016).

### *Scope of this report*

27. This report covers all IMs within the December 2016 decision package except for the CPP requirements IMs. Our decisions on the CPP requirements IMs are instead covered in Topic paper 2: CPP requirements, so that all information about our decisions regarding the CPP requirements (within the scope of the review) is in one place.

### **Structure of this report**

28. Following this introductory chapter, this report is split into three parts that are supported by five attachments.

#### *Part 1 – IM decisions that we have changed*

29. Part 1 lists those pre-review IM decisions that we have changed (either at a policy level, or in terms of the implementation of the decision) as part of the IM review.
30. For each pre-review IM decision that we have changed, Part 1 of this report:
- 30.1 states the pre-review IM decision;
  - 30.2 explains how we have changed it; and
  - 30.3 explains why we have changed it.

#### *Part 2 – IM decisions that we have not changed*

31. Part 2 lists those pre-review IM decisions that:
- 31.1 in light of our framework, submissions on the IM review, and all other relevant information before us, we considered changing; but
  - 31.2 for the reasons presented in Part 2, we have decided not to change.
32. For each pre-review IM decision that we are not changing, Part 2 of this report:
- 32.1 states the pre-review IM decision; and
  - 32.2 explains why we have decided not to change it as part of the IM review.

*Part 3 – IM decisions that we are not changing, and found no reason to consider changing*

33. Part 3 lists those pre-review IM decisions that:
- 33.1 in light of our framework, submissions on the IM review, and all other relevant information before us, we found no reason to consider changing at this stage;<sup>17</sup> and
  - 33.2 we therefore have decided not to change.

*Attachments*

34. Attachment A assists readers in navigating this report by:
- 34.1 listing all pre-review IM decisions in order according to their unique code; and
  - 34.2 indicating where each pre-review IM decision is located in this report.
35. Attachment B explains why we have decided not to adopt the ‘next closest alternative’ (**NCA**) provision that we proposed in our draft decision.
36. Attachment C provides our response to the ENA submission that the existing change event reopener for DPPs and CPPs could be used, if it was modified slightly by removing (or amending) the materiality threshold for change events that affect quality standards. We had earlier received a letter from the ENA setting out a number of concerns relating to Part 4 of the Commerce Act regarding the implementation of the Health and Safety at Work Act 2015.<sup>18</sup>
37. Attachment D provides an illustrative example of how the price setting and wash-up processes may work under a revenue cap in a DPP or CPP for a GTB or EDB.
38. Attachment E explains the timing and transition provisions we have included in the IM amendments determinations. The timing and transition provisions relate to when and how determination amendments made as a result of the IM review come into effect.

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<sup>17</sup> That is not to say there have never been any issues raised in respect of the pre-review IM decisions listed in Part 3 of this report. Minor issues have been raised in the past that are relevant to some of the pre-review IM decisions listed in Part 3; but none that, when we carried out our effectiveness review, we considered were sufficiently material to lead us to consider changing the IMs.

<sup>18</sup> Letter from Graeme Peters (Chief Executive, ENA) to Sue Begg (Deputy Chair, Commerce Commission) regarding the impact of a reduction of live line work on non-exempt EDBs under the default and customised price quality path (October 2016).

## Part 1: IM decisions that we have changed

### Chapter 2: Introduction to Part 1

39. This Part lists those pre-review IM decisions that we have changed (either at a policy level, or in terms of the implementation of the decision) as part of the IM review.
40. For each pre-review IM decision that we have changed, Part 1:
  - 40.1 states the pre-review IM decision;
  - 40.2 explains how we have changed it; and
  - 40.3 explains why we have changed it.
41. This Part also includes a new decision on an existing IM matter.
42. This Part is structured according to the grouping of pre-review IM decisions described in Chapter 1 of this report.<sup>19</sup>

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<sup>19</sup> Part 1 does not have chapters on gas pricing methodologies, amalgamations or 'other regulatory rules and processes' because we do not propose any changes to those decisions.

## Chapter 3: Cost allocation decisions we have changed

### Pre-review cost allocation IM decision CA02

<b>Decision CA02</b> <b>Allocating not directly attributable cost</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs [ie, GDBs and GTBs] must apply one of three complementary approaches to allocate costs that are 'not directly attributable' between each type of regulated service, and between the regulated and unregulated services (in aggregate) they provide:</p> <ul style="list-style-type: none"> <li>• the ABAA;</li> <li>• the optional variation to the accounting based approach (<b>OVABAA</b>); and</li> <li>• ACAM.</li> </ul> <p>See section 3.3, Appendix B, sections B4 to B6 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	EDB/GDB/GTB

#### *How we have changed this decision*

43. Our decision is to make a change to IM decision CA02. As discussed in Topic paper 3: The future impact of emerging technologies in the energy sector, we have removed the avoidable cost allocation methodology (**ACAM**) as a stand-alone cost allocation option for EDBs and GPBs.

#### *Why we have made this change*

44. Our reasons for this change are explained in Topic paper 3: The future impact of emerging technologies in the energy sector.

*Issues we have considered where we have not made a change*

45. In our problem definition paper we proposed to focus on the various definitions of cost to reduce complexity and compliance costs.<sup>20</sup> We received submissions from PwC and the ENA on this point.<sup>21</sup> They both supported aligning cost definitions within the IMs as closely to the GAAP rules as possible, but no specific changes were suggested, and no other submissions mentioned this matter.
46. In reviewing IM decision CA02, we looked at whether we could reduce complexity and compliance costs by using techniques such as alignment with GAAP, while continuing to achieve the policy intent. In doing so we found cases relating to other IM decisions where we have aligned the IMs closer with GAAP or other commercial rules, such as the auditing standards, to help reduce complexity and compliance costs. For example:
- 46.1 the implementation change to IM decision AV17 to GAAP accounting methods to be used for the depreciation of non-system assets;
  - 46.2 the implementation change to IM decisions AV13, AV14 and AV33 so that the financing cost on works under construction aligns with GAAP; and
  - 46.3 the implementation change to the CPP audit requirements so they better align with the auditing standards.<sup>22</sup>

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<sup>20</sup> Commerce Commission “Input methodologies review invitation to contribute to problem definition” (16 June 2015), para 484-485.

<sup>21</sup> PwC “Submission to the Commerce Commission on input methodologies review: Invitation to contribute to problem definition (21 August 2015), para 146; and ENA’s submission on the problem definition paper “Response to the Commerce Commission’s input methodologies review paper” (21 August 2015), para 223-224.

<sup>22</sup> Commerce Commission “Input methodologies review draft decisions: Topic paper 2 – CPP requirements” (16 June 2016), Chapter 7.

### Pre-review cost allocation IM decision CA03

<b>Decision CA03</b> <b>Process for deciding allocation approach</b>	<b>Original 2010 decision</b> <p>The IM specifies the process for deciding which of the three approaches suppliers must use to allocate shared costs in different circumstances.</p> <p>See Appendix B, sections B2 and B3, of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *How we have changed this decision*

47. Our decision is to make a change to IM decision CA03. As discussed in Topic paper 3: The future impact of emerging technologies in the energy sector, we have removed ACAM as a stand-alone cost allocation option for EDBs and GPBs.

#### *Why we have made this change*

48. Our reasons for this change are explained in Topic paper 3: The future impact of emerging technologies in the energy sector.

#### *We have also made an implementation change for this decision*

49. We identified an implementation issue with IM decision CA03. Under the pre-review IMs, distributions to consumer owners were not included in the list of items excluded from operating costs.
50. We have therefore made an implementation change to this IM decision to strengthen the wording of the relevant IM determinations to ensure that distributions to consumers (eg, payments of cash, distributions of product or issuing of shares) are not treated as operating costs.

#### *Why we have made this implementation change*

51. The pre-review IMs had a list of items which were excluded from operating costs. However, distributions to consumer owners were not included on this list. This created some uncertainty about how these distributions were being treated for the purposes of the IMs, which affected the comparability of the ID data.

52. Changing the IMs to clarify that EDBs may not treat distributions to consumer owners as operating costs better gives effect to the intention behind the affected cost allocation provisions, and removes a potential source of uncertainty from the IMs.<sup>23</sup>

#### Pre-review cost allocation IM decision CA04

<b>Decision CA04</b> <b>ABAA causal relationship approach and proxy allocators</b>	<b>Original 2010 decision</b> Under the accounting-based allocation approach ( <b>ABAA</b> ), where possible, cost and asset allocators used to allocate costs to regulated activities must be based on current 'causal relationships'.  Where this is not possible, proxy allocators must be used instead.  See section 3.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *We have made an implementation change for this decision*

53. Our decision is to make an implementation change to IM decision CA04 to improve the way it is implemented. Our decision is to strengthen the wording of the relevant IM determinations to ensure that regulated suppliers that use proxy allocators will explain:
- 53.1 why they have used a proxy rather than a causal allocator; and
- 53.2 why they have used a particular quantifiable measure as the proxy allocator.<sup>24</sup>

#### *Why we have made this change*

54. Our reasons for this change are explained in Topic paper 3: The future impact of emerging technologies in the energy sector.

<sup>23</sup> ENA and Orion supported this change, see: ENA "Input methodologies review – Report on the IM review – Submission to the Commerce Commission" (4 August 2016), p. 6; and Orion "Submission on input methodologies review – draft decisions" (4 August 2016), para 94.3.

<sup>24</sup> In submissions on our technical consultation, ENA argued that the term 'selected quantifiable measure' is confusing. The drafting in the EDB, GDB and GTB IM amendments determinations has been updated to better reflect the requirement to explain the rationale for the quantifiable measure used for the proxy allocator. ENA "Input Methodologies review: Technical consultation update: Submission to the Commerce Commission" (3 November 2016), p. 7.

## Pre-review cost allocation IM decision CA12

<b>Decision CA12</b> <b>Causal relationship approach and proxy allocators – Airports</b>	<b>Original 2010 decision</b> Where possible, cost and asset allocators used to allocate costs to regulated activities must be based on current ‘causal relationships’.  Where this is not possible, proxy allocators must be used instead.  See section 3.3; Appendix B of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

*We have made implementation changes for this decision*

55. We have made two changes to the Airports IM decision CA12 to improve the way the decision is implemented:

55.1 We have strengthened the wording of the Airports IMs to ensure that regulated suppliers that use proxy allocators justify:

55.1.1 why they have used a proxy rather than a causal allocator; and

55.1.2 why they have used the particular quantifiable measure as the proxy allocator(s).<sup>25</sup>

55.2 We have decided to allow airports to also use proxy allocators when applying ABAA for cost allocation and asset allocation if it is impractical to use a causal relationship, and not just if a causal relationship cannot be established.

*Why we have made these changes*

### Strengthened justification for using proxy allocators

56. Our reasons for this change are the same as for the changes to IM decision CA04.

57. We note that NZAA did not support this change for airports, and submitted that there is already constructive engagement between airports and airlines on cost allocation, with positive outcomes for consumers. NZAA considered that the Airport Authorities Act (**AAA**) mandates airport consultation with its customers, and that this is robust and comprehensive.<sup>26</sup>

<sup>25</sup> We have updated the drafting in the airports IM amendments determination to better reflect the rationale for the quantifiable measure used for the proxy.

<sup>26</sup> NZ Airports "Cross submission on Commerce Commission's input methodologies review draft decision" (18 August 2016), para 76-77; and NZ Airports, Untitled submission on IM review technical consultation update paper (3 November 2016), para 14-15.

58. However, we have decided this change should apply to airports, as this will increase the quality of information we receive under information disclosure and will provide us and other stakeholders with more clarity on why a proxy allocator was used.

Allowing the use of proxy allocators if using a causal relationship is impractical

59. We have made this change because we consider that the ability for airports and airlines to develop commercial solutions to cost allocation should not be limited by a requirement that if a causal relationship exists it must be used. This change was suggested by BARNZ and supported by NZAA.<sup>27</sup>

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<sup>27</sup> BARNZ "Submission by BARNZ on the Commerce Commission proposed changes to the Input Methodology and Information Disclosure determinations in relation to the Airport topic" (4 August 2016), p. 13; and NZ Airports "Cross submission on Commerce Commission's input methodologies review draft decision" (18 August 2016), para 74-75.

## Chapter 4: Asset valuation decisions we have changed

### Pre-review asset valuation IM decision AV05

<b>Decision AV05</b> <b>Finance leases and intangible assets</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs may include in their regulatory asset base (<b>RAB</b>) values finance leases and intangible assets provided that they are identifiable non-monetary assets that are not goodwill, consistent with the meanings under generally accepted accounting principles (<b>GAAP</b>).</p> <p>EDBs and GPBs must establish the value of permitted intangible assets added to the RAB value after the last day of the disclosure year 2009 using the cost model for recognition under GAAP.</p> <p>See section E3, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*We have made an implementation change for this decision*

60. Our decision in respect of IM decision AV05 is to make a change to the IMs to improve the way this decision is implemented.
61. We have amended the EDB ‘value of commissioned asset’ to clarify that a finance lease excludes the value of any assets to the extent that annual lease charges are instead included as a recoverable cost.

*Why we have made this change*

62. Under the pre-review implementation of this IM decision AV05 for EDBs, finance leases could be included as an asset in the RAB, while at the same time the associated lease payments were included in recoverable costs.
63. ENA and PwC raised this issue in a February 2014 submission and noted that it appears to be an unintentional consequence.<sup>28</sup> They suggested that the RAB definition of finance leases be adjusted to exclude any value associated with charges included as recoverable costs.

<sup>28</sup> ENA and PwC “Review of Input Methodologies” (14 February 2014), para 28.

64. We have amended the EDB IM determination to reduce the potential for a supplier to 'double dip' the costs of assets that are financed through finance leases if we had also allowed the lease instalments to be treated under a 'new investment contract' as recoverable costs.<sup>29</sup>
65. There is no comparable form of recoverable cost for GDBs or GTBs or Transpower, so no implementation change was required for them.
66. As this issue only arises under price-quality paths, no comparable change to the Airports IMs (ie, IM decision AV44) was required.

#### Pre-review asset valuation IM decision AV09

<b>Decision AV09</b> <b>Capital contributions</b>	<b>Original 2010 decision</b> EDBs and GPBs must recognise capital contributions by adding the asset in question to the RAB value at cost (measured in accordance with GAAP), reduced by the amount of the capital contribution received (where the capital contribution does not reduce the cost of the asset under GAAP).  See section E7, Appendix E of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *We have made implementation changes for this decision*

67. Our decision in respect of IM decision AV09 is to change the IMs to improve the way the existing decision is implemented.
68. We have made the following implementation changes for this IM decision:
- 68.1 Expanded the definition of 'capital contributions' to include money received in respect of asset acquisitions.
- 68.2 Amended the IMs so that the calculation of the financing cost that can be capitalised in the RAB on a commissioned asset is based on a value of works under construction that is net of capital contributions received at any stage. This includes any situation where a capital contribution is received before money is spent on the works.

<sup>29</sup> ENA submitted on our draft decision on how to achieve the policy objective of aligning with the GAAP treatment of finance leases. See ENA "[DRAFT] Electricity Distribution Input Methodologies Determination 2012" (18 August 2016), p. 55 and p. 136.

69. These changes apply to EDBs, GDBs and GTBs. We have similarly amended IM decision AV48 for airports.

*Why we have made these changes*

70. We consider that the policy intent of pre-review IM decision AV09 remains appropriate. However, we have made implementation changes to achieve the policy intent more effectively.

Expanding the definition of 'capital contributions'

71. We consider the scope and definition of capital contributions was too narrow in the pre-review IMs. In particular, we consider there was a gap in how the IMs achieved the policy intent in situations where:
- 71.1 capital contributions were made towards an asset that already existed before being commissioned (eg, the asset is acquired, rather than constructed);
  - 71.2 capital contributions for an asset were received in advance of the asset being constructed or commissioned; or
  - 71.3 capital contributions were spread over the commissioning of assets over time.
72. The pre-review definition of capital contributions was intended to capture any type of consideration received for the purposes of asset construction or enhancement. However, we identified from our effectiveness review that it could have been read that capital contributions for an asset acquisition fell outside of this definition, and so could have potentially avoided being deducted from the RAB when the acquired asset was commissioned.
73. Expanding the definition of capital contributions to include acquisitions improves the clarity of the IMs in a way that achieves the policy intent more consistently, regardless of whether an asset is constructed or acquired.
74. In its submission on our IM review draft determinations, ENA stated that the revised definition of 'capital contributions' including 'money received in respect of asset acquisitions' would not be a workable mechanism or a useable definition of capital contributions.<sup>30</sup> However, in the absence of evidence to the contrary, we consider that expanding the definition to include money received in respect of asset acquisitions is workable and useable.

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<sup>30</sup> ENA "Input Methodologies review – Report on the IM review: Submission to the Commerce Commission" (4 August 2016), p. 7.

### Calculation of the capitalised financing cost

75. The pre-review IM decision allows a financing cost on works under construction to be capitalised to the RAB when a constructed asset is commissioned (ie, when it enters the RAB). However, there were no rules in the IMs to deal with the impact of capital contributions on the calculation of those financing costs where GAAP accounting has not otherwise already reduced the value of the constructed asset by the amount of the capital contributions.
76. The pre-review IMs allowed interest to be capitalised under GAAP from the point at which a project meets the definition of 'works under construction' up until the project becomes a commissioned asset. We consider that for the purpose of calculating financing costs on works under construction to be capitalised into the RAB, the value of those works under construction should be reduced by any capital contributions received.
77. We note that the definition of 'works under construction' in the IMs is broad and is intended to encompass almost any situation where a third party makes a capital contribution towards an asset that has not yet been commissioned, including when assets are forecast for construction.
78. We consider that the receipt of a capital contribution in a case where a project has not otherwise met the 'works under construction' test would signal a forecast construction and would therefore start the clock ticking on a 'works under construction' for the purposes of calculating any capitalised interest.

## Pre-review asset valuation IM decision AV12

<p><b>Decision AV12</b>  <b>Assets purchased from regulated supplier</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Where an EDB or GPB purchases an asset from another regulated supplier it must add the asset to its RAB value at the asset's equivalent value in the RAB of the seller.</p> <p>Where an EDB or GPB purchases an asset from a related party (that does not supply services that are regulated under Part 4), it must add the asset to its RAB at depreciated historic cost where documentation is available to support this.</p> <p>Where sufficient records do not exist to establish depreciated historic cost, it must use the asset's market value as verified by an independent valuer. For this purpose a related party includes both:</p> <ul style="list-style-type: none"> <li>• business units of the same EDB and GPB that supply services other than electricity transmission services; and</li> <li>• a party that under GAAP is considered a related party (including any party that has conducted business either directly or indirectly with the supplier in the current financial year).</li> </ul> <p>See section E8, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2012 amendment to this decision</b></p> <p>In 2012, we amended the treatment of asset valuations in related party transactions in the ID and CPP IMs applicable to EDBs, GDBs and GTBs by:</p> <ul style="list-style-type: none"> <li>• modifying the treatment of asset acquisitions by EDBs, GDBs and GTBs from related parties.</li> <li>• amending the treatment of related party asset acquisitions to provide additional methods for suppliers to establish that these transactions reflect 'arm's-length' equivalent values. These amendments provided greater flexibility for suppliers to address individual circumstances, while continuing to ensure that the arm's-length nature of the transactions is supported by objective criteria.</li> </ul> <p><a href="#">Electricity and Gas Input Methodologies Determination Amendments (No.1) 2012: Reasons Paper (29 June 2012)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

*We have made implementation changes for this decision*

79. Our decision in respect of IM decision AV12 is to make changes to the IMs to:
- 79.1 correct a drafting error to change the EDB, GDB and GTB IM determinations to replace all references to 'related company' in the IM determinations with the term 'related party';<sup>31</sup>
  - 79.2 clarify clause 2.2.11(1)(e) to now reference the 'unallocated closing RAB value' of the transfer or for the purpose of setting the value; and
  - 79.3 amend the IMs so the value of an asset is adjusted for depreciation and revaluation applying in the year of transfer.

*Why we have made these changes*

Related party reference

80. The use of the term 'related company' instead of 'related party' in some parts of the EDB, GDB and GTB IM Determinations appears to have been an error. References to the term 'related company' were not intended to encompass a narrower term than the defined term 'related party'.
81. This issue was raised by ENA and PwC in a submission to us in February 2014.<sup>32</sup>

Removal of circular reference

82. We have clarified clause 2.2.11(1)(e) to avoid a circular reference in the cost value to be used for an asset acquired from a regulated supplier in the EDB, GDB and GTB IM determinations. Clause 2.2.11(1)(e) now references the 'unallocated closing RAB value' of the transferor for the purpose of setting the value. This change enhances clarity. We have also made this change in AV32 for Transpower and AV46 for airports.

Ensuring accurate accounting of depreciation and revaluation for transferred assets

83. The intent of the IMs is that regulated suppliers should not receive more than the total value of an asset in depreciation. However, the pre-review IMs allowed for asset lives to be transferred to the purchaser at their opening RAB value on the vendor's balance sheet. In addition, a transferred asset was treated by the vendor as being a commissioned asset in that year. As such, its value was not depreciated or revalued in the year it was transferred. However, the vendor was still entitled to earn depreciation from this asset (ie, there was no revaluation of the asset).
84. We have addressed this by requiring the asset value for a transferred asset to be the vendor's closing RAB value.

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<sup>31</sup> We have still to reach decisions on other broader aspects of the related party transactions requirements.

<sup>32</sup> ENA and PwC "Review of input methodologies" (14 February 2014), para 14.

85. This change was supported by ENA and First Gas.<sup>33</sup>

*Review of related party transactions provisions ongoing*

86. As discussed in the Introduction and process paper, our review of the related party transactions provisions is ongoing.<sup>34</sup> In February 2017, we expect to publish for consultation an emerging views paper on the problem definition for our review of the related party transaction provisions. The paper will build on the related party transactions topic paper we published in June 2016.<sup>35</sup>

87. Following consultation on our emerging views paper, we expect to publish:

87.1 our draft decision in Q2 2017; and

87.2 our final decision in Q4 2017.

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<sup>33</sup> ENA "Input methodologies review – Report on the IM review – Submission to the Commerce Commission" (4 August 2016), p. 8; and First Gas "Submission on Input methodologies review draft decisions (excluding cost of capital)" (4 August 2016), p. 2.

<sup>34</sup> Commerce Commission "Input methodologies review decisions: Introduction and process paper" (20 December 2016)

<sup>35</sup> Commerce Commission "Input methodologies review draft decisions: Topic paper 7 – Related party transactions" (16 June 2016)

### Pre-review asset valuation IM decision AV13

<b>Decision AV13</b> <b>Financing costs on works under construction – excludes exempt EDBs</b>  <b>(original 2010 decision amended)</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs subject to default/customised price-quality regulation must capitalise financing costs on works under construction in accordance with GAAP, at a rate no greater than the 75<sup>th</sup> percentile for the regulatory post-tax WACC determined under the cost of capital IM, for the purpose of ID and CPPs.</p> <p>See section E5, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>Our final decision was to use the 67<sup>th</sup> percentile estimate of post-tax WACC as a limit when determining the value of commissioned assets under particular provisions of the IMs. This change took effect as of the commencement dates specified in the amendment determination; it did not require subsequent changes to the ID requirements before suppliers were required to apply it.</p> <p><a href="#">Amendments to the WACC percentile range for information disclosure regulation for electricity lines services and gas pipeline services: Reasons Paper (12 December 2014)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *How we have changed this decision*

88. We have amended the IM decision AV13 to require non-exempt EDBs, GDBs and GTBs to use their GAAP cost of financing, capped at its New Zealand dollar weighted average cost of borrowing, when calculating the cost of financing for assets under construction. This is consistent with the change we have made to IM decision AV33 for Transpower.
89. Under this approach, the cost of financing will apply for the period from when the asset becomes a works under construction until its commissioning date.

#### *Why we have made this change*

90. Our reasons for making this change are the same as those for our change to IM decision AV33 for Transpower.

### Pre-review asset valuation IM decision AV14

<b>Decision AV14</b> <b>Financing costs on works under construction – exempt EDBs</b>	<p><b>Original 2010 decision</b></p> <p>Exempt EDBs must capitalise financing costs on works under construction in accordance with GAAP, at a rate no greater than their own estimate of their cost of capital.</p> <p>See section E5, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	Exempt EDBs

#### *How we have changed this decision*

91. We have changed IM decision AV14 to require exempt EDBs to use their GAAP cost of financing, capped at its New Zealand dollar weighted average cost of borrowing, when calculating the cost of financing for assets under construction. Under this approach, the cost of financing will apply for the period from when the asset becomes a works under construction until its commissioning date.

#### *Why we have made this change*

92. We have changed this approach to maintain consistent disclosures for exempt EDBs and non-exempt EDBs (IM decision AV13).

### Pre-review asset valuation IM decision AV17

<b>Decision AV17</b> <b>Standard asset lives apply – with listed exceptions</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs must use the standard asset lives in Schedule A of the IM Determination, with the following exceptions:</p> <ul style="list-style-type: none"> <li>• EDBs and GPBs must depreciate fixed life easements over the expected term of the easement;</li> <li>• For dedicated assets, EDBs and GPBs may assign an asset life equal to the life of the supporting customer contract;</li> <li>• EDBs and GPBs may extend asset lives beyond those provided in the list of standard physical asset lives, and set asset lives for refurbished assets, without an independent engineer's report;</li> <li>• EDBs and GPBs may reduce an asset life, provided the reduced asset life is supported to an independent engineer's report;</li> <li>• EDBs and GDBs must determine when to commence depreciating network spares consistent with GAAP;</li> <li>• Where EDBs and GPBs add a found asset to the RAB, and where an EDB's or GPB's RAB already contains a similar asset, the asset life of the found asset should be the asset life applying to the similar asset.</li> </ul>
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	<p>For assets commissioned in the future that are not covered by the list of standard physical asset lives, regulated suppliers must establish physical asset lives as follows:</p> <ul style="list-style-type: none"> <li>• where an asset of the same type is already in the RAB, using the same asset life as assigned to the existing asset; or</li> <li>• otherwise, by setting an asset life for the asset supported by an independent engineer's report.</li> </ul> <p>For assets in the initial RAB value, the physical asset life will be the asset's existing remaining life as at the balance date for each EDB's or GPB's 2009 disclosures.</p> <p>Where an asset comprises a number of components with differing lives (a 'composite asset'), EDBs and GPBs must calculate the total asset life for the composite asset as a weighted average of the lives of those components.</p> <p>For the purpose of CPP proposals, no system fixed assets should be forecast to be written off during a regulatory period. All such assets in service at the start of a CPP regulatory period are deemed to have a physical asset life equal to the duration of the CPP period.</p> <p>See section E10, Appendix E of 2010 EDP-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*How we have changed this decision*

93. Our decision is to make a policy change to IM decision AV17 as it applies to EDBs, but not to GDBs or GTBs.
94. To implement this policy change, an EDB subject to a DPP is, at the time a DPP is reset, able to propose a factor by which to adjust the weighted average remaining asset life for its existing assets. An EDB that proposes a factor must justify why it requires this adjustment and cannot apply for a factor lower than 0.85. We will then review this proposal, giving consideration to its impact on pricing. The change may be applied by us as a one-off adjustment for any EDB that proposes the change.
95. EDBs will be required to adjust their individual asset lives used for ID to ensure that in the first year of the new regulatory period, the implied weighted average asset life for the purposes of ID is consistent with their new weighted average remaining asset life for the purposes of the DPP. Assets commissioned after this date will have asset lives which are in line with similar assets already in the RAB.

*Why we have made this change*

96. The change allows EDBs the option to adjust asset lives by a moderate amount in certain circumstances. The reasons for this are explained in Topic paper 3: The future impact of emerging technologies in the energy sector. That paper also explains the reasons for our decision not to make the same change to IM decision AV17 as it applies to GPBs.
97. Because asset lives for forecast commissioned assets are already only an approximation (ie, 45 years irrespective of the type of asset), the change for new assets will not affect the way the DPP is reset.<sup>36</sup> However, any approved reduction in asset lives will affect the depreciation amounts of both existing and commissioned assets reported under ID during the DPP regulatory period, and will therefore affect the RAB at the beginning of the following DPP period.
98. In subsequent regulatory periods, the weighted average asset life for existing assets will be calculated using the RAB and depreciation from the ID in the relevant base year. No further adjustment factor will be applied.
99. Because of the added complication that would occur if we allowed EDBs to make multiple adjustments, EDBs will only ever be allowed to make one adjustment.

*We have also made implementation changes for this decision*

100. We have made the following changes to IM decision AV17 to improve the way the existing decision is implemented for EDBs, GDBs and GTBs:
- 100.1 amended the IMs so that the asset life of non-system assets is determined by applying the asset life used under GAAP;
- 100.2 amended the IMs to make it clear that asset lives are not reset on transfers of assets; and
- 100.3 in respect of CPP depreciation, amended the IMs to remove a requirement for suppliers to spread depreciation for 'end of life' assets over the regulatory period.
101. For EDBs, we have changed IM decision AV17 to expand the list of assets in Schedule A to include additional asset descriptions and their associated standard physical asset lives.

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<sup>36</sup> Commerce Commission "Specification and Amendment of Input Methodologies as Applicable to Default Price-Quality Paths: Reasons paper" (28 September 2012), para 55.2.

*Why we have made these implementation changes*

Allowing the use of GAAP for non-system assets

102. This change reduces complexity and compliance costs, without reducing the effectiveness of the IM in achieving its policy intent.
103. Under the pre-review IMs, if an asset did not have a standard asset life and there were no similar assets already in the RAB, the EDB, GDB and GTB IMs required the asset life to be the physical service life potential as determined by an engineer.
104. ENA and PwC submitted that, although the use of an engineer is appropriate for system assets, an engineer might not be the most appropriate person to assess the physical service life potential of non-system assets (eg, office equipment or motor vehicles).<sup>37</sup>
105. We agree with this point and consider that there is no alternative to using GAAP for non-system assets that would justify the additional compliance costs.
106. If this amendment has a consequential impact on the depreciation of EDBs' non-system assets, the potential influence on the price path will be minimal, as non-system assets only make up around 3% of total assets in the RAB for EDBs.
107. This change was supported by ENA and First Gas.<sup>38</sup>

Clarifying that asset lives are not reset upon transfer

108. This change clarifies the application of the existing IM decision. The intent of the IMs is that asset lives should not change as a result of a transfer. However, one possible interpretation of the pre-review IMs suggested that the asset lives were treated as being commissioned at the date of acquisition. This would have meant inappropriately treating aged assets as if they were brand new when they were acquired. Maintaining existing asset lives and allowing the adoption of asset lives of similar assets is consistent with the original policy intent.
109. This change was supported by ENA and First Gas.<sup>39</sup>

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<sup>37</sup> ENA and PwC "Review of input methodologies" (14 February 2014), para 35.

<sup>38</sup> ENA "Input methodologies review – Report on the IM review – Submission to the Commerce Commission" (4 August 2016), p. 8; and First Gas "Submission on Input methodologies review draft decisions (excluding cost of capital)" (4 August 2016), p. 2.

<sup>39</sup> ENA "Input methodologies review – Report on the IM review – Submission to the Commerce Commission" (4 August 2016), p. 8; and First Gas "Submission on Input methodologies review draft decisions (excluding cost of capital)" (4 August 2016), p. 2.

Removing the requirement to spread CPP depreciation for ‘end of life’ assets over the CPP regulatory period

110. Under the pre-review CPP IMs, for EDBs, GDBs and GTBs, suppliers were required to spread depreciation for ‘end of life’ assets over the CPP regulatory period.<sup>40</sup>
111. The requirement was difficult for suppliers to implement due to the complexity of accounting for a change in the depreciation rate for assets at the end of their lives, and this calculation was performed purely to satisfy this requirement.
112. The rationale for deleting this requirement is for the same reasons articulated in the August 2014 Transpower IPP Reasons Paper.<sup>41</sup> It also means there is consistency across the sectors.
113. This change was supported by ENA and First Gas.<sup>42</sup>

Expanding the list of assets in Schedule A to include additional asset descriptions

114. ENA and PwC and MDL submitted that the list of assets with standard asset lives (ie, those included in Schedule A of each relevant IM determination) was missing a number of important assets.<sup>43, 44</sup> They suggested we expand the list of standard asset lives to include additional assets (both network and non-network) that regulated suppliers commonly hold.
115. We have amended Schedule A for EDBs to include additional assets that reflect new technology. We reviewed and agreed with the suggested standard asset lives for those additional assets. They are consistent with other similar assets and manufacturer specifications. The additions to Schedule A mean suppliers no longer require an independent engineer’s report to estimate asset lives for the applicable assets.<sup>45</sup>

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<sup>40</sup> This requirement was removed from Transpower’s IPP in August 2014.

<sup>41</sup> Commerce Commission “Setting Transpower’s individual price-quality path for 2015-2020” (29 August 2014).

<sup>42</sup> ENA “Input methodologies review – Report on the IM review – Submission to the Commerce Commission” (4 August 2016), p. 8; and First Gas “Submission on Input methodologies review draft decisions (excluding cost of capital)” (4 August 2016), p. 2.

<sup>43</sup> ENA and PwC “Review of input methodologies” (14 February 2014), para 34.

<sup>44</sup> MDL, Untitled submission on problem definition paper (21 August 2015), p. 13-14.

<sup>45</sup> The additions we have included in Schedule A were suggested by ENA and supported by Vector. See: Letter from Graeme Peters (Chief Executive, ENA) to Keston Ruxton (Manager, Commerce Commission) re ENA submission on DRAFT Electricity Distribution Services Input Methodology Determination (18 August 2016), p. 2; and Vector “Vector submission on the draft amended input methodologies determinations” (3 November 2016), Appendix A, Table 1.

*Issues we have considered where we have not made a change*

116. We also considered whether we should amend the list of standard asset lives in Schedule A to reflect submissions that the (pre-review) asset lives on that list should be updated.<sup>46</sup>
117. We did not make changes to the pre-review IM asset lives because we considered that some of the changes suggested would be likely to contribute to a material component of the RAB, particularly the change relating to the wood poles' asset lives. We note that suppliers have the ability to change asset lifetimes for material components of the asset base with an engineer's report.
118. We have not made implementation changes for GDBs or GTBs equivalent to the changes to EDB IM determination Schedule A, Table A.2 (Asset lives for CPP commissioned assets). As outlined in paragraph 25 of this report, the CPP information requirements for gas are outside of the scope of our decisions package and will be addressed later.

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<sup>46</sup> These amendments were suggested by ENA and supported by Vector. See: Letter from Graeme Peters (Chief Executive, ENA) to Keston Ruxton (Manager, Commerce Commission) re ENA submission on DRAFT Electricity Distribution Services Input Methodology Determination (18 August 2016), p. 2; and Vector "Vector submission on the draft amended input methodologies determinations" (3 November 2016), Appendix A, Table 1.

## Pre-review asset valuation IM decision AV32

<p><b>Decision AV32</b></p> <p><b>Purchase of assets from regulated supplier or related party – Transpower</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Where Transpower purchases an asset from another regulated supplier it must add the asset to its RAB value at the asset's equivalent value in the RAB of the seller.</p> <p>Where Transpower purchases an asset from a related party (provided the related party is not itself a regulated supplier), it must add the asset to its RAB value at depreciated historic cost where documentation is available to support this.</p> <p>Where sufficient records do not exist to establish depreciated historic cost, it must use the asset's market value as verified by an independent valuer. For this purpose a related party includes both:</p> <ul style="list-style-type: none"> <li>• business units of Transpower that supply services other than electricity transmission services; and</li> <li>• a party that under GAAP is considered a related party (including any party that has conducted business either directly or indirectly with the supplier in the current financial year).</li> </ul> <p>See section 4.4, paragraphs 4.4.81 – 4.4.84 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>Amendment to this decision</b></p> <p>The amendment affects the IMs relating to ID regulation and individual price-quality regulation for Transpower. It will apply with effect from 1 July 2015 which corresponds to the commencement date of the first disclosure year for RCP2:</p> <p>We have amended the definition of 'related party' to exclude those parties that are related to Transpower solely by virtue of the Crown's ownership of Transpower.</p> <p>The term 'related party' is used in a number of places in the IMs, such as determining the regulatory value of assets acquired by Transpower from a related party under clause 2.2.7(1).</p> <p>The current definition draws on the meaning of 'related' under GAAP which has the effect of including Transpower's shareholder (the Crown), the arms of the Crown (eg, Government departments) and State-Owned Enterprises such as Meridian Energy.</p> <p>Limiting the definition so as to specifically exclude parties related to Transpower via the Crown is expected to reduce Transpower's costs from complying with related party requirements, while still upholding the policy intent of the requirement.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper</a></p>
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	<a href="#">(28 August 2014)</a>
<b>This original decision applies to (sector):</b>	Transpower

*We have made an implementation change for this decision*

119. We have clarified clause 2.2.7(1)(f) to now reference the ‘unallocated closing RAB value’ of the transfer or for the purpose of setting the value. This change has also been made to AV12 for EDBs, GDBs and GTBs and AV46 for airports.

*Why we have made this change*

120. We have made this change to avoid a circular reference in the cost value to be used for an asset acquired from a regulated supplier in the Transpower IM Determination. We have made this change to enhance clarity.

### Pre-review asset valuation IM decision AV33

<p><b>Decision AV33</b>  <b>Financing costs on works under construction – Transpower</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower must capitalise financing costs on works under construction in accordance with GAAP, at a rate no greater than the 75<sup>th</sup> percentile for the regulatory post-tax WACC determined under the cost of capital IM.</p> <p>When it commissions works under construction, Transpower must reduce the cost of the asset, established consistent with GAAP, by the amount of any revenue derived in relation to the assets while they were works under construction (where such a reduction is not already made under GAAP, and where the revenue has not already been reported as income under ID).</p> <p>See section 4.4, paragraphs 4.4.31 – 4.4. 48 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>Our final decision was to use the 67<sup>th</sup> percentile estimate of post-tax WACC as a limit, when determining the value of commissioned assets under particular provisions of the IMs. This change took effect as of the commencement dates specified in the amendment determination and discussed further below; it did not require subsequent changes to the ID requirements before suppliers were required to apply it.</p> <p><a href="#">Amendments to the WACC percentile range for information disclosure regulation for electricity lines services and gas pipeline services: Reasons Paper (12 December 2014)</a></p>
<b>This original decision applies to (sector):</b>	Transpower

*How we have changed this decision*

121. We have amended IM decision AV33 to require Transpower to use its GAAP cost of financing, capped at its New Zealand dollar weighted average cost of borrowing, when calculating the cost of financing for assets under construction. We have also removed the WACC rate cap.

*Why we have made this change*

122. Prior to the review the IMs had allowed Transpower to account for the financing cost of the construction of assets in a manner which is consistent with GAAP, subject to a cap that prevents it from using a cost of financing that is higher than its WACC rate.
123. Transpower has argued that the WACC rate cap is problematic for it.<sup>47</sup> This is because Transpower uses long term debt and when interest rates decrease rapidly (as it has in the period since the global financial crisis), it faces debt rates for financing its construction that are higher than its WACC. This created a compliance cost for Transpower, as the value of its assets under GAAP is then higher than the value of its assets for regulatory purposes. This meant that it had to either invest disproportionate amounts to maintain two fixed asset registers or apply a complex adjustment process to keep its asset values for GAAP and the IMs aligned.
124. As the cost of borrowing would generally be expected to be lower than the cost of equity (the other component of the WACC), there are few cases where we expect this situation to arise. Indeed, this does not seem to be an issue at the present time. Nonetheless, this situation did arise for a period following the global financial crisis and it is possible that a swift decrease in interest rates might cause it to arise again.
125. For the reasons stated in the 2010 Reasons Paper, we are hesitant to allow the use of GAAP on an unconstrained basis for this purpose.<sup>48</sup> We consider the better approach in the circumstances, which is consistent with our 2010 decision, is to require Transpower to use its GAAP cost of financing, capped at its average cost of borrowing. This gives Transpower an incentive to seek the most appropriate source of debt. The approach we have adopted is consistent with the approach most companies are likely to take in calculating their cost of financing under GAAP for this purpose, as few have project-specific debt (which would allow for a different treatment under GAAP accounting standards).

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<sup>47</sup> Letter from Jeremy Cain (Transpower) to Dane Gunnell (Senior Analyst, Commerce Commission) regarding amendments to Transpower Input Methodologies for RCP2 (14 June 2013), p. 5. Available at: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/amendments-and-clarifications/>.

<sup>48</sup> Commerce Commission "Input methodologies (Transpower) reasons paper" (December 2010), para 4.4.41a.

126. We note that Transpower has stated that it does use the GAAP approach in setting a capitalisation rate for the purposes of capitalising its cost of financing its capital expenditure (**capex**).<sup>49</sup> The accounting standard applicable to Transpower under GAAP has the following features:<sup>50</sup>

- 126.1 to the extent that the company borrows funds generally and uses them for the purpose of capex, it determines the cost of financing eligible for capitalisation by applying a capitalisation rate to its capex projects;
- 126.2 the capitalisation rate is the weighted average of the borrowing costs applicable to the company's borrowings that are outstanding during the year, taking into account the costs or benefits of any hedging of borrowing of any included foreign currency funds; and
- 126.3 the amount of borrowing costs that the company capitalises to assets during a year must not exceed the amount of borrowing costs it incurred during that year.

#### Pre-review asset valuation IM decision AV35

<p><b>Decision AV35</b>  <b>Standard physical asset lives to apply with exceptions – Transpower</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower must use the standard physical asset lives in Schedule A of the IM Determination, with the following exceptions:</p> <ul style="list-style-type: none"> <li>• Transpower must depreciate fixed life easements over the expected term of the easement;</li> <li>• for dedicated assets, Transpower may assign an asset life equal to the life of the supporting customer contract;</li> <li>• Transpower may extend asset lives beyond those provided in the list of standard physical asset lives, and set asset lives for refurbished assets, without an independent engineer's report;</li> <li>• Transpower may reduce an asset life, provided the reduced asset life is supported to an independent engineer's report;</li> <li>• Transpower must determine when to start depreciating network spares consistent with GAAP;</li> <li>• where Transpower adds a found asset to the RAB value, and where Transpower's RAB already contains a similar asset, the asset life of</li> </ul>
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<sup>49</sup> Letter from Jeremy Cain (Transpower) to Dane Gunnell (Senior Analyst, Commerce Commission) regarding amendments to Transpower Input Methodologies for RCP2 (14 June 2013), p. 5. Available at: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/amendments-and-clarifications/>.

<sup>50</sup> See: New Zealand Equivalent to International Accounting Standard 23 (NZ IAS 23), para 14.

the found asset should be the asset life applying to the similar asset;

- for assets commissioned in the future that are not covered by the list of standard physical asset lives:
  - where an asset of the same type is already in the RAB, Transpower must use the same asset life as assigned to the existing asset; or
  - otherwise set asset lives for the assets, provided they are supported by an independent engineer's report.
- where an asset comprises a number of components with differing lives (a 'composite asset'), Transpower must calculate the total asset life for the composite asset as a weighted average of the lives of those components.

Total (unallocated) depreciation over the lifetime of the asset, must not exceed the value at which the asset is first recognised in the RAB under Part 4 (after adjusting for the effects of revaluations).

See section 4.4, paragraphs 4.4.109-4.4.129 of 2010 Transpower IM reasons paper:

[Input Methodologies \(Transpower\) Reasons Paper \(22 December 2010\)](#)

#### **2014 amendment to this decision**

The amendment affects the IMs relating to ID regulation and individual price-quality regulation for Transpower. The new depreciation treatment applies to assets commissioned on or after 1 July 2015. The pseudo asset for the 2015–2020 regulatory control period (**RCP2**) is also established on that date. This corresponds to the commencement date of the first disclosure year for RCP2.

We amended the IMs governing asset valuation to allow depreciation to be calculated for assets in the year in which those assets are commissioned. Depreciation calculations under the existing IMs commences for regulatory purposes in the year *following* the year of commissioning of new assets.

The calculation of depreciation is pro-rated for the year to reflect the portion of the year that the assets are commissioned.

If the treatment had applied from 2011 when Transpower's initial RAB was determined then regulatory asset values in 2015 could be expected to be approximately \$50 million less. Transpower requested that its regulatory asset values be adjusted to eliminate this difference from 2015.

To achieve this in an NPV neutral manner the IMs require regulatory asset values to be decreased, and the amount of the decrease to be established as an 'RCP2 pseudo asset' as at the first day of the 2016 disclosure year. The pseudo asset will then be depreciated over a period of 31 years, which

	<p>Transpower has advised is the average remaining asset life of affected assets.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<b>This original decision applies to (sector):</b>	Transpower

*We have made implementation changes for this decision*

127. We have made the following implementation changes for IM decision AV35:

- 127.1 amended the Transpower IM Determination so that the asset life of non-system assets is determined by applying the asset life used under GAAP;
- 127.2 amended the Transpower IM Determination to make it clear that asset lives are not reset on transfers of assets from other regulated suppliers; and
- 127.3 amended the Transpower IM Determination so the value of an asset is adjusted for depreciation applying in the year of transfer from the other regulated supplier.

*Why we have made these changes*

128. We have made equivalent implementation changes in the IMs for EDBs, GDBs and GTBs by amending IM decision AV17. Our reasoning for making these changes to IM decision AV35 is the same as for IM decision AV17.

#### **Pre-review asset valuation IM decision AV40**

<p><b>Decision AV40</b></p> <p><b>RAB roll forward with indexation – Airports</b></p>	<p><b>Original 2010 decision</b></p> <p>Airports must roll forward the initial value of their non-land assets using consumer price index (CPI) indexation. For this purpose airports must use the 'All Groups Index SE9A' published by Statistics New Zealand. For each quarter prior to the December 2010 quarter, airports must multiply the CPI value from that index by 1.02, to adjust for the recent change in GST.</p> <p>See section 4.3; Appendix C, section C13 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

*How we have changed this decision*

129. Our decision is to change IM decision AV40 to:

- 129.1 require airports to disclose forward-looking and backward-looking costs in a way that is most consistent to the approaches used when setting prices;

- 129.2 limit airports in their approaches to revaluing assets to the use of either CPI-indexation or an un-indexed approach (except when revaluing land using Market Value Alternative Use (**MVAU**)); and
- 129.3 allow airports to make their choice of either CPI-indexation or an un-indexed approach for each subset of the asset base separately.

*Why we have made these changes*

- 130. Our reasons for these changes are explained in Topic paper 5: Airports profitability assessment.

## Pre-review asset valuation IM decision AV41

<p><b>Decision AV41</b> Initial RAB values for land assets and revaluation approach – Airports</p> <p>(original 2010 decision amended)</p>	<p><b>Original 2010 decision</b></p> <p>Airports:</p> <ul style="list-style-type: none"> <li>• must establish initial RAB values for their land assets, as on the last day of the disclosure year 2009, using the market value alternative use (<b>MVAU</b>) approach specified in Schedule A of the IM Determination;</li> <li>• can revalue airport land in their RAB value using an MVAU valuation approach, in accordance with Schedule A, in any disclosure year. For revaluations to be recognised in the RAB value, they must encompass all land held by the Airport in its RAB value. All future development land must be revalued using a MVAU approach as at the same date. In years in which no MVAU revaluation is undertaken, land in the RAB value and future development land must be CPI-indexed. For this purpose airports must use the ‘All Groups Index SE9A’ published by Statistics New Zealand (CPI values prior to December 2010 must be multiplied by 1.02).</li> </ul> <p>See section 4.3, Appendix C, sections C2 and C13 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>High Court judgment in <i>Wellington International Airports Ltd and others v Commerce Commission</i> [2013] NZHC 3289 (11 December 2013) and Commerce Commission “Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court” (27 November 2014). See amended clauses 3.2(1)(b) and 3.7(6)(c) of the Airports IM Determination:</p> <ul style="list-style-type: none"> <li>• amend the disclosure year for the ‘unallocated initial RAB value’ for land from ‘disclosure year 2009’ to ‘disclosure year 2010’; and</li> <li>• the ‘unallocated revaluation’ of land and ‘revaluation’ of land in disclosure year 2010 are nil.</li> </ul> <p><a href="#">Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court (27 November 2014)</a></p> <p><a href="#">Wellington International Airport Ltd &amp; Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013]</a></p>
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	<p><b>2016 amendment to this decision (2)</b></p> <p>We decided to incorporate the latest valuations standards by reference into Schedule A of the Airport IMs.</p> <p>We amended Schedule A of the Airport IMs to provide additional direction on the information required to be included in the valuer’s report in order to support the valuation. The additional information includes:</p> <ul style="list-style-type: none"> <li>• where material to the valuation, economic analysis to support the highest and best alternative use (<b>HBAU</b>) plan;</li> <li>• other expert opinions obtained by the valuer, where the valuer is not suitably experienced or qualified to provide an expert opinion;</li> <li>• information to support the value of rezoning costs included in the MVAU; and</li> <li>• all material assumptions and special assumptions made in undertaking the valuation.</li> </ul> <p>“The amendments introduced through [the] fast track process are intended to clarify that the treatment of remediation costs also applies to the costs associated with rezoning airport land. In particular, in determining the MVAU of the land, it is assumed that airport zoning does not apply.</p> <p>Our decision is to remove any inconsistencies in, and repetition between, and within, the Schedule A requirements, explanatory notes and reference statements.</p> <p>Market-based evidence for estimating the eventual gross realisations or estimated value of the land can only be used to the extent that the use is unaffected by the supply of specified airport services.”</p> <p><a href="#">Input methodologies review – Amendments to input methodologies for airports land valuation – Final reasons paper for the airports fast track review (24 February 2016)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Airports</p>

*How we have changed this decision*

131. Our decision is to make a change to IM decision AV41 by introducing a pragmatic proxy for the initial RAB value for land as at 2010, by interpolating 2009 and 2011 RAB land values based on existing MVAU valuations.
132. Our decision changes IM decision AV41 by amending the mechanism for determining the unallocated initial RAB value of land in the Airports IM Determination to:

- 132.1 no longer determine the value as on the last day of the disclosure year 2010 in accordance with the Airports Land Valuation Methodology; and
- 132.2 instead, determine the value by using a proxy for the initial RAB value as at 2010 by interpolating 2009 and 2011 RAB land values based on existing MVAU valuations.
133. As a consequence of introducing a formula for using a proxy for the initial RAB value as at 2010 by interpolating 2009 and 2011 RAB values, we have introduced a definition for 'capital expenditure'. As discussed in Topic paper 5: Airports profitability assessment, capital expenditure is needed to determine the average of the 2010 interpolated land value.

*Why we have made these changes*

134. Our reasons for these changes are explained in Topic paper 5: Airports profitability assessment.
135. Also, in its submission on the draft decision, NZAA noted that the definition for 'capital expenditure' in the IM determination is different to the definition used in the ID determination.<sup>51</sup>
136. We have not changed the definition of 'capital expenditure' in either the Airport IMs or ID Determinations. Although the definition for 'capital expenditure' in the Airports ID Determination and our drafting in the Airport IMs Determination is different, we do not consider these definitions to be inconsistent. The definition in the Airport IMs Determination provides a principled view of 'capital expenditure', while the definition in the Airports ID Determination provides a more prescriptive view for the purpose of meeting the specific ID requirements.

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<sup>51</sup> NZ Airports technical drafting comments on "[DRAFT] Amendment to the Commerce Act (Specified Airport Services Input Methodologies) Determination 2010" (18 August 2016), p. 6.

## Pre-review asset valuation IM decision AV42

<p><b>Decision AV42</b>  <b>RAB exclusions –</b>  <b>Airports</b></p> <p><b>(original 2010</b>  <b>decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Airports should exclude from their RAB values:</p> <ul style="list-style-type: none"> <li>• any assets not used to provide specified airport services, as defined in s 56A;</li> <li>• future development land;</li> <li>• any asset that is part of works under construction;</li> <li>• working capital;</li> <li>• goodwill; and</li> <li>• easement land, that is land acquired for the purpose of creating an easement, and with the intention of subsequently disposing of the land.</li> </ul> <p>See section 4.3; Appendix C, sections C3, C4, C5, C10 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>High Court judgment in <i>Wellington International Airports Ltd and others v Commerce Commission</i> [2013] NZHC 3289 (11 December 2013) and Commerce Commission “Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court” (27 November 2014). See amended clause 3.12(3) of the Airports IM Determination:</p> <p>For the purpose of land that is works under construction on the last day of disclosure year 2009, Auckland International Airport’s cost of constructing the Northern Runway must not exceed \$22.3 million.</p> <p><a href="#">Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court (27 November 2014)</a></p>
<p><b>This original decision</b>  <b>applies to (sector):</b></p>	<p>Airports</p>

### *How we have changed this decision*

137. Our decision is to make a change to IM decision AV42 by amending the definition of net revenue on excluded assets (in particular, in relation to assets held for future use, eg, future development land). This ensures that if an airport included revenues on assets held for future use through a special levy, this would be captured in the definition of net revenue and not included as regulatory income.

138. This IM change is supported by changes to the Airports ID Determination, as discussed in Topic paper 5: Airports profitability assessment.
139. Our decision changes the definition of “net revenue” in clause 3.11(6)(c) of the Airport IMs to make the policy intent clearer (ie, all revenues derived from or associated with assets held for future use would be captured in the definition of net revenue).
140. We have clarified that ‘revenue’ derived in relation to determining the value of commissioned assets is ‘post-tax’.<sup>52</sup>

*Why we have made this change*

141. Our reasons for this change are explained in Topic paper 5: Airports profitability assessment.
142. Auckland Airport raised an issue about the treatment of assets held for future use which are considered excluded assets (such as land held for future use) in the IMs.<sup>53</sup>
143. We use a post-tax WACC to calculate the value of excluded assets whereas net revenue is calculated on a pre-tax basis. This means that under the IMs as they are currently implemented, an asset ultimately gets transferred to a RAB value which is lower than the post-tax cost of commissioning of the asset (after adjusting for net income). This difference is equal to the tax paid on the net revenue derived from the excluded asset.
144. Auckland Airport may choose to include revenues associated with excluded assets relating to its proposed second runway in advance of the runway being commissioned when setting prices at its next price setting event. We consider there is value in using the roll forward of excluded assets as a method of accounting for forecast revenues associated with the second runway on an *ex-ante* basis in ID. However, Auckland Airport has indicated that it will not elect to use this approach if the IM is not appropriately amended to address the tax issue.<sup>54</sup>
145. Since land is not depreciated over time (and is treated independent of additions to the RAB), it is not possible for airports to recover the tax they have incurred on revenue derived from the excluded asset through a depreciation charge. We consider the most practical way to address this issue is to change the definition of ‘net revenue’ for this purpose to reflect it on an after-tax basis.

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<sup>52</sup> NZ Airports Association “[DRAFT] ID and IM determinations” (18 August 2016), p. 24.

<sup>53</sup> Auckland Airport “Problem definition for input methodologies review: submission to Commerce Commission” (21 August 2015), para 70.

<sup>54</sup> Auckland Airport “Problem definition for input methodologies review: submission to Commerce Commission” (21 August 2015), para 70.

146. There are instances where revenues received are required to be applied against the cost of an asset for the purpose of working out the financing cost on an asset that is not yet commissioned. We have clarified that any 'revenue' derived in this respect is to be treated as 'post-tax'. We have clarified this to reflect that the cost of financing of assets that are not yet commissioned should be applied to the net carrying cost of those assets. That carrying cost is the cost of the asset less the net benefit of any associated revenues received before commissioning. The net benefit comprises the associated gross revenues less the amount payable in income tax on those revenues.

*Issues we have considered where we have not made a change*

147. Auckland Airport has recently raised a concern about whether the IMs unintentionally cause holding costs for works under construction to be treated as excluded costs.<sup>55</sup> In its submission on the draft decision, Auckland Airport stated that it no longer considered this to be an issue and provided an interpretation on whether holding costs can enter the RAB when the asset held for future use is commissioned.<sup>56</sup> We agree with Auckland Airport's interpretation and consider that the Airport IMs do not need to be amended to reflect this interpretation.
148. In its submission on the draft decision, BARNZ suggested removing 'other than those included in total regulatory income under an ID determination or preceding regulatory information disclosure requirements' in clause 3.11(6)(c) on the basis that they 'imply that there is a choice for where to record income from assets held for future use' in Schedules 2/4 of the Airports ID Determination. BARNZ suggested that all 'income relating to assets held for future use should be recorded in Schedule 4 and so act (hopefully) to reduce the cost of holding the asset'.<sup>57</sup>
149. We have not amended the Airport IMs Determination. We consider that the current language makes our intention of treating assets held for future use distinct from total regulatory income.

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<sup>55</sup> Email and attachment from Emma Rae (Senior Advisor, Auckland Airport) to Jo Perry (Senior Analyst, Commerce Commission) raising issues with assets held for future use (4 May 2016), Section C. The email and attachment are available on our website at: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/airport-profitability-assessment/>.

<sup>56</sup> Auckland Airport "Review of input methodologies: Submission on Commerce Commission draft decision" (4 August 2016), para 35.

<sup>57</sup> BARNZ "Technical drafting comments on [DRAFT] Amendment to the Commerce Act (Specified Airport Services Input Methodologies) Determination 2010" (18 August 2016), p. 27.

## Pre-review asset valuation IM decision AV46

<p><b>Decision AV46</b>  <b>Purchase of assets from regulated supplier or related party – Airports</b></p>	<p><b>Original 2010 decision</b></p> <p>If an airport purchases an asset from another supplier of services regulated under Part 4, then it must add the asset to its RAB value at the asset's equivalent value in the RAB of the seller.</p> <p>Where an Airport purchases an asset from a related party (that does not supply services that are regulated under Part 4), it must add the asset to its RAB value at depreciated historic cost where documentation is available to support this.</p> <p>Where sufficient records do not exist to establish depreciated historic cost, the Airport must use the asset's market value as verified by an independent valuer. The market value must be established using the MVAU approach in the case of land, and must not exceed the asset's depreciated replacement cost for non-land assets. For this purpose a related party includes both:</p> <ul style="list-style-type: none"> <li>• business units of the Airport that supply services other than specified airport services; and</li> <li>• a party that under GAAP is considered a related party (including any party that has conducted business either directly or indirectly with the supplier in the current financial year).</li> </ul> <p>See section 4.3, Appendix C, section C7 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Airports</p>

### *We have made an implementation change for this decision*

150. We have clarified clause 3.9(1)(d) to now reference the 'unallocated closing RAB value' of the transferor for the purpose of setting the value. This change has also been made to AV12 for EDBs, GDBs and GTBs and AV32 for Transpower.

### *Why we have made this change*

151. We have made this change to avoid a circular reference in the cost value to be used for an asset acquired from a regulated supplier in the airports IM Determination. We have made this change to enhance clarity.

## Pre-review asset valuation IM decision AV48

<b>Decision AV48</b> <b>Capital contributions and vested assets – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports must recognise capital contributions by adding the asset in question to the RAB value at cost (measured in accordance with GAAP), reduced by the amount of the capital contribution received (where the capital contribution does not reduce the cost of the asset under GAAP).</p> <p>Airports must include vested assets in the RAB value at the cost to the Airport. The cost at which the asset enters the RAB value may not exceed the amount of consideration paid by the Airport in respect of that asset.</p> <p>See Appendix C section C9, of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

### *We have made implementation changes for this decision*

152. Consistent with an implementation change made for IM decision AV09, we have made the following implementation changes for this IM decision:
- 152.1 expanded the definition of ‘capital contributions’ to include money received in respect of asset acquisitions; and
  - 152.2 amended the IMs so that the calculation of the financing cost that can be capitalised in the RAB on a commissioned asset is based on a value of works under construction that is net of capital contributions at any stage. This would include any situation where a capital contribution is received before money is spent on the works.

### *Why we have made these changes*

153. Our reasons for making these implementation changes to IM decision AV48 are the same as our reasons for the implementation changes we have made for IM decision AV09.
154. The current definition of ‘capital contributions’ is consistent between the EDB, GDB, GTB and Airports IMs. The way in which financing costs are calculated and capitalised to the RAB is also similar in these IMs.

## Pre-review asset valuation IM decision AV50

<b>Decision AV50</b> <b>Straight line depreciation applies with election to use non-standard approach – Airports</b>	<b>Original 2010 decision</b> Airports must depreciate their assets on a straight line basis, unless they elect to use a non-standard depreciation approach (subject to the ID Determination). No depreciation is to be applied to land and easements (other than fixed life easements).  See Appendix C, section C11 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

### *We have made an implementation change for this decision*

155. Our decision in respect of IM decision AV50 is to make an implementation change to improve the effectiveness of the pre-review decision.
156. Specifically, we have supplemented the pre-review non-standard depreciation rules in the IMs with principles to help guide the application of the provisions.
157. This IM change is supported by changes to the relevant ID determinations, as discussed in Topic paper 5: Airports profitability assessment.

### *Why we have made this change*

158. Our reasons for this change are explained in Topic paper 5: Airports profitability assessment.

## Pre-review asset valuation IM decision AV54

<b>Decision AV54</b> <b>Initial RAB value –</b> <b>Powerco GDB</b>  <b>(2013 decision)</b>	<p><b>Original 2013 decision</b></p> <p>Our final decision in June 2012 was to effect a change to Powerco’s year-end to 30 September and leave the remaining gas businesses disclosure year-ends unchanged. This ensures that that correct initial RAB value for Powerco is established as of the commencement date of the Part 4 regulatory regime. The initial RAB values for Vector and GasNet remain unchanged.</p> <p>As discussed in our final decision, the amendments include an adjustment to Powerco’s initial RAB values for the 3-month period 30 June to 30 September 2009.</p> <p>The changes will take effect from the date of amendment. Calculations of RAB values and other values (such as roll forward deferred tax balances) will incorporate the effect of the changes so that, for example, the effect of the changes on RAB values will be apparent from 2009 in the upcoming 2013 gas distribution ID for Powerco.</p> <p><a href="#">Implementing the change to Powerco’s disclosure year: Technical briefing paper on amendments to gas input methodologies (3 December 2013)</a></p>
<b>This decision applies to (sector):</b>	GDBs (Powerco only)

### *How we have changed this decision*

159. Our decision in respect of IM decision AV54 is to remove references to ‘Maui Development Limited’ in the definition of ‘disclosure year’, as well as the references which indicate that MDL’s disclosure year ‘means the preceding calendar year’ in the GTB IM.
160. Consistent with the airports, EDB and GDB IM determinations, we have amended the GTB IM definition of ‘disclosure year’ to allow the corresponding definition of ‘disclosure year’ in the ID determination to provide a specific date for applicable regulated suppliers.
161. The decision now also applies to GTBs.

### *Why we have made this change*

162. We have removed references to ‘Maui Development Limited’ in the definition for ‘disclosure year’ and ‘means the preceding calendar year’, as these references are no longer required due to the First Gas purchase of MDL. Removing these references will allow the GTB ID determination to specify the First Gas disclosure year.

163. Rather than specifying the disclosure year for First Gas' GTB in the IM determination, we will consider amending the GTB ID determination definition of 'disclosure year' as part of our next round of ID amendments. We intend to update the reporting requirements in the GTB ID determinations as part of an overall update of the EDB, GDB, GTB and Transpower ID determinations. We will be updating those ID determinations to account for general amendments to the requirements and to incorporate amendments made to the applicable IM determinations.

#### **New asset valuation IM decision AV55**

164. We have made a new asset valuation IM decision AV55:

<b>Decision AV55</b> <b>Giving effect to IM decisions – applying alternative methodologies with equivalent effect – Airports</b>	<b>New 2016 decision</b> <p>To give effect to other IM decisions, we allow alternative methodologies with equivalent effect (<b>AMWEEs</b>) to be available to airports as an alternative to a number of other methodologies for disclosing information under ID, provided the alternative methodologies produce an effect that is likely to be equivalent to those other methodologies.</p> <p>Alternative methodologies can only be applied in place of the roll forward of the RAB for capex, disposals, depreciation and revaluations specified in the asset valuation IMs.</p> <p>We have specified the criteria that must be met in order for alternative methodologies to be applied, and the information required to be provided by an airport to demonstrate that it meets the specified criteria.</p>
<b>This decision applies to (sector):</b>	Airports

#### *We have made a new IM decision*

165. We have decided that airports may apply alternative methodologies with equivalent effect when making disclosures under ID.
166. We have specified the criteria that must be met in order for alternative methodologies to be applied, and the information required to be provided by an airport to demonstrate that it meets the specified criteria.
167. This IM change is supported by changes to the Airports ID Determination, as discussed in Topic paper 5: Airports profitability assessment.

#### *Reasons for the new decision*

168. Our reasons for this change are explained in Topic paper 5: Airports profitability assessment.

169. We have made this new decision because it may be more appropriate or cost effective for an airport to have the option to establish and roll forward the value of the RAB based on using an aggregated RAB rather than having to establish the RAB on an individual asset basis (as is currently required in the asset valuation IMs in the Airport IMs Determination).

## Chapter 5: Treatment of taxation decisions we have changed

### Pre-review treatment of taxation IM decision TX01

<b>Decision TX01</b> <b>Modified deferred tax approach applies – EDBs and GDBs</b>	<b>Original 2010 decision</b> Tax costs must be estimated using a ‘modified deferred tax’ approach.  Specification of modified deferred tax approach (eg, how the deferred tax balance is calculated and cost allocation adjustments are treated).  See section 5.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB

*We have made an implementation change for this decision*

170. In respect of IM decision TX01, our decision is to make a change to the IMs to improve the way the existing determination is implemented.
171. We have amended the EDB and GDB IM determinations so that the ID and CPP IM calculation for closing deferred tax includes an adjustment for asset disposals.

*Why we have made this change*

172. ENA and PwC submitted that the EDB IM closing deferred tax provisions should include asset disposals to align with the EDB ID requirements, which include an adjustment for disposals in their closing deferred tax calculation.<sup>58</sup> In its submission on our draft decisions, Orion also supported this change.<sup>59</sup>
173. The EDB ID and GDB ID determinations define ‘closing deferred tax’ by reference to the definition in the IMs. The IM formulae have no adjustment for the deferred tax in respect of asset disposals. However, ‘closing deferred tax’ in the EDB ID and GDB ID determinations do.
174. As ‘deferred tax balance relating to assets disposed in the disclosure year’ is a subtracted part of the ‘closed deferred tax’ calculation in the ID schedules, and to improve consistency between the determinations, it should also be subtracted in the deferred tax formulae in the EDB and GDB IM determinations. The reference to the IMs in each ID determination definition of ‘closing deferred tax’ would then remain consistent and relevant.

<sup>58</sup> ENA and PwC “Review of input methodologies” (14 February 2014), para 6. ENA “Input Methodologies review – Report on the IM review” (4 August 2016), para 19.

<sup>59</sup> Orion “Submission on Input Methodologies review – draft decisions” (4 August 2016), para 110.1.

175. Because the GTB, Airports and Transpower IMs do not include deferred tax in their tax calculations (ie, they all use the 'tax payable' method of calculation of tax), we have not amended those IM determinations for asset disposals.

*Issues we have considered where we have not made a change*

176. This is a consequential issue we considered that follows on from our asset transfer decisions under IM decision AV12. Our decision in respect of IM decision TX01 is to make no change with respect to the treatment of deferred taxation following the transfer of assets.
177. The treatment of tax is different between the Transpower and EDB IM determinations, which may create issues for determining the regulatory investment value in spur asset transfers from Transpower to an EDB. However, spur asset transfers are not common and we do not wish to create additional complexity by unnecessarily amending the tax IM requirements. We instead provide the following guidance, rather than an amendment to the EDB IM determination.
178. We have not amended the EDB IM Determination for spur asset transfers. As such, the opening deferred tax an EDB uses in its regulatory investment value calculation will be zero.
179. Having no opening deferred tax value means that when an EDB calculates its regulatory investment value, it will use the opening RAB value provided by Transpower for the spur asset and will not need to estimate the opening deferred tax value.
180. Making no amendments to the treatment of deferred taxation for the spur asset also means that we have made no consequential changes to IM decision TX14 for Transpower.

## Pre-review treatment of taxation IM decision TX02

<p><b>Decision TX02</b></p> <p><b>Tax legislation and cost allocation to be applied – EDBs</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>When calculating regulatory taxable income, the cost allocation IM and tax legislation (to the extent practicable) are to be used, subject to other relevant provisions in the IMs. Debt interest should be calculated using a notional leverage that is consistent with the cost of capital IM.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendments to this decision</b></p> <p>See para 2.2, 2.3, 3.2, 3.3, 4.2, 4.3 – Electricity Distribution Services Input Methodology Amendments Determination 2014 [2014] NZCC 31 (27 November 2014).</p> <p><i>Definition of notional deductible interest</i></p> <p>This amendment changes the definition of notional deductible interest used in the treatment of taxation IMs to apply a mid-year cash-flow timing assumption to the calculation of notional interest amounts. The current IMs assume year-end payments rather than payments being made during the year.</p> <p>The amendment provides formulas that assume interest payments are to be made continuously through the year at a constant rate, which would be closely equivalent to a single interest payment being made at mid-year. The interest payable amount is discounted using the cost of debt.</p> <p><i>Correction to double deduction of TCSD allowance</i></p> <p>This amendment corrects the double deduction of the TCSD allowance when calculating the regulatory tax allowance for the treatment of taxation IMs for DPPs.</p> <p>The TCSD is included as a deduction in the definitions of both the regulatory profit / (loss) before tax and the regulatory tax adjustments and clause 4.3.1 uses these two terms to derive the regulatory tax allowance. As a result, the TCSD allowance is incorrectly deducted twice when calculating the regulatory tax allowance.</p> <p><i>Correction to amortisation of initial differences</i></p> <p>This amendment corrects the definition of amortisation of initial differences in asset values to take account of the changes in initial difference values that result from the age, sale and acquisition of relevant assets.</p> <p>Clause 4.3.3(3) defines the ‘amortisation of initial differences in asset values’ for each disclosure year as the ‘initial differences in asset values’ divided by the ‘weighted average remaining useful life of relevant assets’.</p>
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	<a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a>
<b>This decision applies to (sector):</b>	EDBs

*We have made implementation changes for this decision*

181. In respect of IM decision TX02, our decision is to make a change to the IMs to improve the way the pre-review decision is implemented.
182. We considered ENA and PwC’s submission on the issue of whether the definition for ‘weighted average remaining useful life of relevant assets’ needs to be defined in the IM determinations.<sup>60</sup>
183. We have:
- 183.1 changed references to ‘weighted average remaining useful life of relevant assets’ to ‘opening weighted average remaining useful life of relevant assets’; and
- 183.2 defined ‘opening weighted average remaining useful life of relevant assets’ to provide greater clarity about what the term means.

*Why we have made these changes*

184. We have made these changes to align with the language in the EDB ID Determination.
185. The same implementation changes have been made for the GDB IM Determination, as implementation changes to IM decision TX08.

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<sup>60</sup> ENA and PwC “Review of input methodologies” (14 February 2014), para 17.

## Pre-review treatment of taxation IM decision TX04

<b>Decision TX04</b> <b>Regulatory tax asset value of asset acquired</b>	<b>Original 2010 decision</b> The regulatory tax asset value of acquired assets should remain unchanged in the event of an acquisition of assets used to supply services that are regulated under Part 4.  See Appendix G of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*We have made an implementation change for this decision*

186. In respect of IM decision TX04, our decision is to make a change to the IMs to improve the way the existing decision is implemented.
187. We have made an implementation change to address the tax effect on capital contributions in the applicable clauses of the EDB, GDB and GTB IM determinations when an asset is bought or sold between suppliers, so that those clauses include the phrase:
- limited to its **value of commissioned asset** or, if relevant **capital contributions** are treated for tax purposes in accordance with section CG 8 of the Income Tax Act 2007 (or subsequent equivalent provisions), limited to the **value of commissioned asset** plus any taxed **capital contributions** applicable to the asset.
188. The same implementation change has been made for the Airports IM Determination, as a change to IM decision TX20.

*Why we have made this change*

189. The amendment provides a common sense adjustment where EDBs, GPBs and airports are at risk of incorrectly recovering an amount of tax, and is generally consistent with a submission from PwC and ENA.<sup>61</sup> In its submission on our draft decisions, Orion also supported this change.<sup>62</sup>
190. PwC and ENA suggested amending the relevant clauses of the EDB ID and CPP IMs to now include the wording:<sup>63</sup>

limited to its value of commissioned asset, unless the EDB treats capital contributions under

<sup>61</sup> ENA and PwC “Review of input methodologies” (14 February 2014), para 7.

<sup>62</sup> ENA “Input Methodologies review – Report on the IM review” (4 August 2016), para 19 and Orion “Submission on Input Methodologies review – draft decisions” (4 August 2016), para 110.2.

<sup>63</sup> ENA and PwC “Review of input methodologies” (14 February 2014), para 7.

section CG 8 of the Income Tax Act 2007, in which case it is limited to its value of commissioned asset plus any capital contributions applicable to the asset which are included in the tax asset value.

191. We generally agree with this position, but have further clarified the suggested drafting. We consider that the value impact on the amount of revenue recoverable from customers adds further clarity on the operation of s CG 8 of the Income Tax Act 2007 when applying the IMs.
192. Because the Transpower IMs do not have rules relating to capital contributions, we have not amended the Transpower IMs.<sup>64</sup>

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<sup>64</sup> *Transpower Input Methodologies Determination 2012* [2012] NZCC 17.

## Pre-review treatment of taxation IM decision TX08

<p><b>Decision TX08</b> Tax legislation and cost allocation to be applied – GDBs and GTBs</p> <p>(original 2010 decision amended)</p>	<p><b>Original 2010 decision</b></p> <p>When calculating regulatory taxable income, the cost allocation IM and tax legislation (to the extent practicable) are to be used, subject to other relevant provisions in the IMs. Debt interest should be calculated using a notional leverage that is consistent with the cost of capital IM.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2013 amendments to this decision</b></p> <p><i>Definition of notional deductible interest</i></p> <p>This amendment changes the definition of notional deductible interest used in the treatment of taxation IMs to apply a mid-year cash-flow timing assumption to the calculation of notional interest amounts. The current IMs assume year-end payments rather than payments being made during the year.</p> <p><i>Correction to double deduction of TCSD allowance</i></p> <p>This amendment corrects the double deduction of the TCSD allowance when calculating the regulatory tax allowance for the treatment of taxation IMs for DPPs.</p> <p>The TCSD is included as a deduction in the definitions of both the regulatory profit/(loss) before tax and the regulatory tax adjustments and clause 4.3.1 uses these two terms to derive the regulatory tax allowance. As a result, the TCSD allowance is incorrectly deducted twice when calculating the regulatory tax allowance.</p> <p><a href="#">Amendments to input methodologies for gas distribution and transmission services: Reasons paper (26 February 2013)</a></p>
<p><b>This original decision applies to (sectors):</b></p>	<p>GDB/GTB</p>

### *We have made implementation changes for this decision*

193. In respect of IM decision TX08, our decision is to make changes to the IMs to improve the way the existing decision is implemented.
194. We have aligned the ‘amortisation of initial differences’ provisions in the GDB DPP IM to the language used in the EDB DPP IM ‘regulatory tax adjustments’ provisions.
195. We have also changed references to ‘weighted average remaining useful life of relevant assets’ in the GDB IM Determination to ‘opening weighted average remaining useful life of relevant assets’.

*Why we have made these changes*

196. As part of the 27 November 2014 EDB IM amendments, we corrected the definition of ‘amortisation of initial differences in asset values’ in the EDB DPP tax IM to take account of the changes in initial difference in values that result from the age, sale and acquisition of relevant assets.<sup>65</sup>
197. Currently the “Regulatory tax adjustments” provisions of the GDB DPP tax IM contain the language used in the EDB tax IM as it was before our 27 November 2014 amendments.<sup>66</sup>
198. To improve consistency between the EDB and GDB DPP tax IMs, we have amended the GDB DPP tax IM “amortisation of initial differences” clauses to use the same language as in the updated EDB DPP tax IM.<sup>67</sup>
199. We have made the change to the references in the GDB IMs to align with the language in the GDB ID Determination and our change for EDBs in IM decision TX02.

*Issue we considered where we have not made a change*

200. MDL submitted that it has problems applying the IM requiring tax information to be disclosed.<sup>68</sup> MDL is not subject to income tax, so cannot provide the relevant tax information required by the IM. Nevertheless, we do not propose any changes to the IMs for this issue.
201. The issue identified by MDL arises from its pre-existing joint venture structure. However, MDL ceased to supply regulated services under this structure. All current GTB services provided by the Maui joint venture are now provided by a single entity under the new First Gas ownership.
202. While an acceptable substitute for the required tax information will need to be provided by First Gas for the upcoming GTB DPP reset, there no longer appears to be any benefit in changing the IMs in response to this issue.

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<sup>65</sup> Commerce Commission “Input Methodology amendments for electricity distribution services: Default price-quality paths” (27 November 2014), para 4.1-4.9.

<sup>66</sup> *Gas Distribution Services Input Methodologies Determination 2012* [2012] NZCC 27, Clause 4.3.3.

<sup>67</sup> *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26, Clause 4.3.3.

<sup>68</sup> MDL, Untitled submission on problem definition paper (21 August 2015), p. 14.

### Pre-review treatment of taxation IM decision TX16

<b>Decision TX16</b> <b>Tax payable approach applies – Airports</b>	<b>Original 2010 decision</b> An Airport’s tax obligations should be estimated using a ‘tax payable’ approach.  See section 5.3 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

#### *How we have changed this decision*

203. Our decision is to change IM decision TX16 to allow airports to apply alternative taxation methodologies with equivalent effect when applying alternative asset valuation methodologies with equivalent effect under IM decision AV55.

#### *Why we have made this change*

204. Consistent with IM decision AV55, we consider that airports should appropriately reflect the tax applicable when using alternative asset valuation methodologies with equivalent effect. This may require some variation from the standard ‘tax payable’ approach. This change to IM decision TX16 provides airports with the flexibility to more accurately reflect the tax applicable.

### Pre-review treatment of taxation IM decision TX20

<b>Decision TX20</b> <b>Regulatory tax asset value of asset acquired from another supplier- Airports</b>	<b>Original 2010 decision</b> The regulatory tax asset value of assets acquired from another airport or from a supplier of another type of regulated service should remain unchanged in the event of an acquisition of assets used to supply services under Part 4.  See Appendix D, section D2 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

#### *We have made an implementation change for this decision*

205. In respect of IM decision TX20, our decision is to make a change to the IMs to improve the way the decision is implemented.

206. Consistent with IM decision TX04, we have made an implementation change to address the tax effect on capital contributions in the applicable clauses of the Airport IMs Determination when an asset is bought or sold between regulated suppliers, so that the clause includes the phrase:

limited to its **value of commissioned asset** or, if relevant **capital contributions** are treated for tax purposes in accordance with section CG 8 of the Income Tax Act 2007 (or subsequent equivalent provisions), limited to the **value of commissioned asset** plus any taxed **capital contributions** applicable to the asset.

207. We have made the same implementation change to address the tax effect on capital contributions in the applicable clauses of the Airports IM Determination when an asset is bought or sold between suppliers as we have made for EDBs, GDBs and GTBs under IM decision TX04.

*Why we have made this change*

208. Our reasons for this implementation change are the same as those set out for the amendment to IM decision TX04.

## Chapter 6: Cost of capital decisions we have changed

### Pre-review cost of capital IM decision CC03

<p><b>Decision CC03</b></p> <p><b>Commission to publish annual WACC estimates</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>The Commission will publish annually for all regulated suppliers:</p> <ul style="list-style-type: none"> <li>• a mid-point estimate of the 5-year post-tax WACC and vanilla WACC to apply under ID regulation; and</li> <li>• an estimate of 5-year vanilla WACC at the 75<sup>th</sup> percentile to apply in setting DPPs and CPPs under default/customised price-quality regulation.</li> </ul> <p>Three- and 4-year equivalent estimates of the vanilla WACC at the 75<sup>th</sup> percentile will also be published as required for CPPs, and estimated WACC ranges for the 25<sup>th</sup> to the 75<sup>th</sup> percentiles for both the post-tax WACC and the vanilla WACC will be published to inform interested persons.</p> <p>See sections 6.7, H14 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>This amendment gives effect to the Commission's decision to move from using the 75<sup>th</sup> percentile estimate of WACC to the 67<sup>th</sup> percentile estimate of WACC for the purposes of price-quality regulation for electricity lines services and gas pipeline services. This amendment does not amend the WACC percentile range used for ID regulation. Our decision was that the specified WACC for EDBs, Transpower and GPBs should be amended, in light of evidence we gathered since the IMs were first determined in December 2010. Our decision was that the 67<sup>th</sup> percentile of our estimated WACC distribution should be used for price-quality path regulation (the 75<sup>th</sup> percentile is currently used). Our decision was given effect to by amending the cost of capital IMs applying to those businesses.</p> <p>This amendment to the WACC percentile applies to EDBs on a DPP and to Transpower's IPP when the resets of those price-quality paths take effect in 2015.</p> <p><a href="#">Amendment to the WACC percentile for price-quality regulation for electricity lines services and gas pipeline services: Reasons paper (30 October 2014)</a></p>
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	<p><b>2014 amendment to this decision (2)</b></p> <p>Our decision was not to amend the 25<sup>th</sup> to 75<sup>th</sup> percentile range for ID for electricity lines services and gas pipeline services. These percentile estimates of WACC continue to be determined and published annually, along with the mid-point estimate (which is also currently published annually). In addition, we annually determine and publish 67<sup>th</sup> percentile estimates so that these are available to ourselves and other interested persons to be used in analysing the performance of suppliers.</p> <p><a href="#">Amendments to the WACC percentile range for information disclosure regulation for electricity lines services and gas pipeline services: Reasons Paper (12 December 2014)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*How we have changed this decision*

209. Our decision is to make the following changes in respect of IM decision CC03:

209.1 We will no longer publish a specific CPP WACC; and

209.2 The WACC used for CPPs will be the prevailing DPP WACC (see also IM decision RP02, which will apply where the DPP WACC changes during the course of the CPP).

210. We have also removed the formula for calculating the standard error of the debt premium. Removing the formula means that a fixed value of the standard error of the debt premium is applied, and therefore a fixed value for the overall standard error of the WACC can be set. We have determined that the standard error of the WACC should be 0.0101 for EDBs and 0.0105 for GPBs.

*Why we have made these changes*

211. The reasons for these changes are discussed in Topic paper 4: Cost of capital issues.

*We have also made an implementation change for this decision*

212. We have made an implementation change in respect of IM decision CC03.

213. We will determine mid-point estimates of post-tax WACC and 67<sup>th</sup> percentile estimates of post-tax WACC for EDBs, GDBs and GTBs

*Why we have made this implementation change*

214. The post-tax WACC will be specified in DPPs or CPPs as the WACC rate to be used in revenue wash-ups and for the roll forward of revenue-related balances (eg, for wash-up balances of revenue that will not be recovered until a later year).

215. This implementation change is the same as the change to IM decision CC13 for Transpower.

## Pre-review cost of capital IM decision CC05

<b>Decision CC05</b> <b>Cost of debt in WACC estimates</b>	<p><b>Original 2010 decision</b></p> <p>For all regulated suppliers, the cost of debt is estimated as:</p> <p style="text-align: center;"><i>risk free rate + debt premium + debt issuance costs</i></p> <ul style="list-style-type: none"> <li>• the risk free rate is estimated by the Commission as part of publishing annual WACCs for all regulated suppliers. The risk free rate is estimated from the observed market yield to maturity of benchmark vanilla New Zealand Government NZ\$ denominated nominal bonds with a term to maturity that matches the term of the regulatory period (typically 5 years);</li> <li>• the debt premium is also estimated by the Commission as part of publishing annual WACCs for all regulated suppliers as the difference between the risk free rate and the yield on publicly traded corporate bonds for EDBs and GPBs with a Standard and Poor's (<b>S&amp;P</b>) long-term credit rating of BBB+ and a term to maturity which matches the regulatory period (typically 5 years); and</li> <li>• debt issuance costs are 35 basis points (0.35%) p.a.</li> </ul> <p>See sections 6.3; H2, H4, H5, H14 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

### *How we have changed this decision*

216. Our decision in respect of IM decision CC05 is to change:

216.1 the risk-free rate – we will continue to use the prevailing risk-free rate, but using three months of data instead of one month;

216.2 the debt premium – we will now determine an ‘average debt premium’, which is an average of the debt premiums estimated over the preceding five years. We have also changed our debt premium estimation methodology to:

216.2.1 use 12 months of bond data instead of one month;

216.2.2 modify the government ownership limitation so that only bonds from 100% government owned entities are subject to the limitation; and

216.2.3 reference the ‘Nelson-Siegel-Svensson curve’ (**NSS curve**) as something we will have regard to when estimating the debt premium;

216.3 debt issuance costs – we have changed this from 35 basis points (0.35%) p.a. to 20 basis points (0.20%) p.a.; and

216.4 swap costs – we have removed an allowance for swap costs from the TCSD and instead include it in the above value of debt issuance costs (see also IM decision CC06).

217. We have not changed the credit rating.

*Why we have made these changes*

218. The reasons for these changes are discussed in Topic paper 4: Cost of capital issues.

#### **Pre-review cost of capital IM decision CC06**

<b>Decision CC06</b> <b>Term credit spread differential allowance may apply</b>	<b>Original 2010 decision</b> <p>A separate TCSD allowance is calculated for qualifying suppliers reflecting the additional costs associated with holding a longer-term debt portfolio. The TCSD is used to adjust cash flows in ID and DPP regulation and is applied to allowable revenue calculations in CPP regulation.</p> <p>Qualifying suppliers are suppliers which have a debt portfolio with a weighted average original tenor exceeding the length of the regulatory period.</p> <p>See sections 6.1, 6.3, H6 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*We have made an implementation change for this decision*

219. Our decision is to make an implementation change in respect of IM decision CC06.

220. The change is to use a fixed linear relationship to determine the additional debt premium associated with debt issued with an original maturity term of more than five years. In doing so, we will no longer include an allowance for swap costs as part of the TCSD (see IM decision CC05 above).

*Why we have made this change*

221. The reasons for this change are discussed in Topic paper 4: Cost of capital issues.

*Issues we considered where we have not made a change*

222. ENA and PwC suggested that the IMs for EDBs and GPBs be changed to make it clear that the most recently published financial statements used to define a qualifying supplier are those published most recently prior to disclosure of the TCSD allowance under ID.<sup>69</sup>
223. We do not consider this is an issue that requires changes to the IM determinations. We consider it is already clear from the IM determinations that the most recently published financial statements used to define a qualifying supplier are those published most recently prior to disclosure of the TCSD allowance under ID.

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<sup>69</sup> ENA and PwC “Review of Input Methodologies” (14 February 2014), para 27.

## Pre-review cost of capital IM decision CC07

<p><b>Decision CC07</b>  <b>Cost of equity in WACC estimates</b></p>	<p><b>Original 2010 decision</b></p> <p>Cost of equity is estimated using the simplified Brennan-Lally Capital Asset Pricing Model (<b>CAPM</b>) as:</p> $\text{risk free rate} \times (1 - \text{investor tax rate}) + \text{equity beta} \times \text{TAMRP}$ <ul style="list-style-type: none"> <li>• the risk free rate is the same as for the cost of debt;</li> <li>• the equity beta for EDBs and Transpower is 0.61 and for GPBs is 0.79, derived from: <ul style="list-style-type: none"> <li>○ an asset beta for EDBs of 0.34 and for GPBs of 0.44; and</li> <li>○ leverage of 44% for EDBs and GPBs;</li> </ul> </li> <li>• the investor tax rate is the maximum prescribed investor tax rate under the Portfolio Investment Entities (<b>PIE</b>) tax regime, which is 30% until 30 September 2010 and 28% thereafter. Changes in the prescribed rate will flow through to future WACC estimates automatically; and</li> <li>• The tax adjusted market risk premium (<b>TAMRP</b>) is 7.5% until 30 June 2011 and 7% thereafter. The TAMRP is expressed as a 5-year composite rate (to match the term of the regulatory period), hence the TAMRP estimated for the 5-year period which commences on 1 July 2010 is 7.1% and for the 5-year period which commences on 1 July 2011 is 7%.</li> </ul> <p>See sections 6.3 to 6.6; H2 to H10 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

### *How we have changed this decision*

224. Our decision in respect of IM decision CC07 is to make changes to:

- 224.1 the equity beta estimate for EDBs – we have changed this from 0.61 to 0.60;
- 224.2 the equity beta estimate for GDBs and GTBs – we have changed this from 0.79 to 0.69;
- 224.3 the asset beta estimate for EDBs – we have changed this from 0.34 to 0.35;
- 224.4 the asset beta estimate for GDBs and GTBs – we have changed this from 0.44 to 0.40 (because we have changed the asset beta adjustment for GDBs and GTBs from 0.1 to 0.05);
- 224.5 the leverage estimate for EDBs and GPBs – we have changed this from 44% to 42%; and
- 224.6 our approach for calculating the asset beta – we have updated the comparator sample and then estimated an average asset beta looking at four-weekly (rather than monthly) and weekly estimates over the two most recent five-year periods.

225. The TAMRP remains at 7%.

*Why we have made these changes*

226. The reasons for these changes are discussed in Topic paper 4: Cost of capital issues.

#### **Pre-review cost of capital IM decision CC10**

<b>Decision CC10</b> <b>Date for determining price-quality path estimates of WACC – EDBs and Transpower</b>  <b>(2014 decision)</b>	<b>Original 2014 decision</b> We changed the date by which we must determine the estimates of WACC used for setting the DPP for EDBs and the IPP for Transpower New Zealand Limited from 30 September to 31 October for 2014. We have done this by changing: <ul style="list-style-type: none"> <li>• the date by which we estimate the WACC percentile for electricity lines businesses; and</li> <li>• the dates by which inputs to the WACC percentile (the risk-free rate, debt premium, and the standard error of the debt premium and mid-point estimates of WACC) are determined or estimated.</li> </ul> <p><a href="#">Amendment to the WACC determination date for electricity lines services, including Transpower: Reasons paper (29 September 2014)</a></p>
<b>This decision applies to (sectors):</b>	EDBs/Transpower

*We have made an implementation change for this decision*

227. In respect of IM decision CC10, our decision is to change the date in the IM determinations by which we must determine the estimates of WACC used for setting the DPP for EDBs and the IPP for Transpower from 31 October to 30 September. In 2014, we used 31 October as the date by which we were required to estimate the WACC to apply for the 2015-2020 EDB DPP and 2015-2020 Transpower IPP.

*Why we have made this change*

228. As we have estimated the WACC to apply for the 2015-2020 EDB DPP and 2015-2020 IPP for Transpower, we have now reverted to our pre-2014 date of 30 September, which will apply for future resets.

## Pre-review cost of capital IM decision CC13

<p><b>Decision CC13</b>  <b>Commission to publish annual WACC estimates – Transpower</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>The Commission will:</p> <ul style="list-style-type: none"> <li>• publish annually a mid-point estimate of the 5-year vanilla and post-tax WACC, as well as 25<sup>th</sup> and 75<sup>th</sup> percentile estimates of vanilla and post-tax WACC, to apply under ID regulation; and</li> <li>• determine, as at 7 months prior to the start of the regulatory period, an estimate of a 5-year vanilla WACC at the 75<sup>th</sup> percentile to apply in setting the IPP for Transpower. The Commission will publish this WACC no later than one month after estimating it.</li> </ul> <p>For the 2010–2015 regulatory control period (<b>RCP1</b>), the Commission will determine the WACC to apply as soon as practicable after the IM comes into force.</p> <p>See sections 6.7, 6.2 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>This amendment gives effect to the Commission's decision to move from using the 75<sup>th</sup> percentile estimate of WACC to the 67<sup>th</sup> percentile estimate of WACC for the purposes of price-quality regulation for electricity lines services and gas pipeline services. This decision does not amend the WACC percentile range used for ID regulation.</p> <p>Our decision is that the specified WACC for EDBs, Transpower and GPBs should be amended, in light of evidence we have gathered since the IMs were first determined in December 2010. Our decision is that the 67<sup>th</sup> percentile of our estimated WACC distribution should be used for price-quality path regulation (the 75<sup>th</sup> percentile is currently used). Our decision has been given effect by amending the cost of capital IMs applying to those businesses.</p> <p>This amendment to the WACC percentile will apply to EDBs on a DPP and to Transpower's IPP when the resets of those price-quality paths take effect in 2015.</p> <p><a href="#">Amendment to the WACC percentile for price-quality regulation for electricity lines services and gas pipeline services: Reasons paper (30 October 2014)</a></p> <p><b>2014 amendment to this decision (2)</b></p> <p>Our decision is not to amend the 25<sup>th</sup> to 75<sup>th</sup> percentile range for ID for electricity lines services and gas pipeline services. These percentile estimates of WACC will continue to be determined and published annually, along with the mid-point estimate (which is also currently published annually).</p>
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	<p>We will annually determine and publish 67<sup>th</sup> percentile estimates so that these are available to ourselves and other interested persons to be used in analysing the performance of suppliers.</p> <p><a href="#">Amendments to the WACC percentile range for information disclosure regulation for electricity lines services and gas pipeline services: Reasons Paper (12 December 2014)</a></p>
<b>This original decision applies to (sector):</b>	Transpower

*How we have changed this decision*

229. Our decision is to make a change to IM decision CC13. We have removed the formula for calculating the standard error of the debt premium. Removing the formula means that a fixed value of the standard error of the debt premium is applied, and therefore a fixed value for the overall standard error of the WACC can be set. We have determined that the standard error of the WACC should be 0.0101 for Transpower.

*Why we have made this change*

230. Our reasons for changing this decision are discussed in Topic paper 4: Cost of capital issues.

*We have also made an implementation change for this decision*

231. We have made an implementation change in respect of IM decision CC13.
232. We will determine mid-point estimates of post-tax WACC and 67<sup>th</sup> percentile estimates of post-tax WACC for Transpower.

*Why we have made this implementation change*

233. The post-tax WACC will be specified in IPPs as the WACC rate to be used in revenue wash-ups and for the roll forward of revenue-related balances in the Transpower EV account (eg, for wash-up balances of revenue that will not be recovered until a later year).
234. This implementation change is the same as the change to IM decision CC03 for EDBs, GDBs and GTBs.

## Pre-review cost of capital IM decision CC15

<b>Decision CC15</b> <b>Cost of debt in WACC estimates – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>For all regulated suppliers, cost of debt is estimated as:</p> <p style="text-align: center;"><i>risk free rate + debt premium + debt issuance costs</i></p> <ul style="list-style-type: none"> <li>• the risk free rate of return is estimated by the Commission as part of publishing annual WACCs for all regulated suppliers. The risk free rate is estimated from the observed market yield to maturity of vanilla NZ Government NZ\$ denominated nominal bonds with a term to maturity that matches the term of the regulatory period (5 years);</li> <li>• the debt premium is also estimated by the Commission as part of publishing annual WACCs for all regulated suppliers as the difference between the risk free rate and the yield on publicly traded corporates bonds for EDBs and GPBs with a BBB+ S&amp;P long-term credit rating and a term to maturity which matches the regulatory period (5 years); and</li> <li>• debt issuance costs are 35 basis points (0.35%) p.a.</li> </ul> <p>See sections 6.3, H2, H4, H5 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

### *How we have changed this decision*

235. Our decision in respect of IM decision CC15 is to make changes to:

235.1 the risk-free rate – we will continue to use the prevailing risk-free rate, but using three months of data instead of one month;

235.2 the debt premium – we will now determine an ‘average debt premium’, which is an average of the debt premiums estimated over the preceding five years. We have also changed our debt premium estimation methodology to:

235.2.1 use 12 months of bond data instead of one month;

235.2.2 modify the government ownership limitation so that only bonds from 100% government owned entities are subject to the limitation; and

235.2.3 reference the ‘Nelson-Siegel-Svensson curve’ (NSS curve) as something we will have regard to when estimating the debt premium;

235.3 debt issuance costs – we have changed this from 35 basis points (0.35%) p.a. to 20 basis points (0.20%) p.a.; and

235.4 swap costs – we have removed an allowance for swap costs from the TCSD. It is now included in the above value of debt issuance costs (see IM decision CC16).

236. We have not changed the credit rating.

*Why we have made these changes*

237. The reasons for these changes are discussed in Topic paper 4: Cost of capital issues.

### Pre-review cost of capital IM decision CC16

<b>Decision CC16</b> <b>Term credit spread differential allowance may apply – Transpower</b>  <b>(original 2010 decision amended)</b>	<p><b>Original 2010 decision</b></p> <p>A separate TCSD allowance is calculated for qualifying suppliers reflecting additional costs associated with holding a longer-term debt portfolio. The TCSD is used to adjust cash flows in ID and individual price-quality regulation and is applied to allowable revenue calculations in the IPP. Qualifying suppliers have a debt portfolio with a weighted average original tenor exceeding the regulatory period (5 years).</p> <p>See sections 6.1, 6.3, H6 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>The implementation of the 2010 decision for the TCSD allowance uses the Bloomberg New Zealand ‘A’ fair value curve, which is no longer produced by Bloomberg.</p> <p>In 2014 we changed the implementation of this decision to allow use of the New Zealand Dollar Interest Rate Swap Curve as reported by Bloomberg plus the mean of the credit spreads of New Zealand corporate ‘A-band’ rated bonds as reported by Bloomberg.</p> <p>See page 15 of the companion paper that accompanied the amendment to the Transpower IM Determination:  <a href="#">Companion Paper to the Update of Transpower’s Maximum Allowable Revenues for the 2016/17 to 2019/20 Pricing Years</a></p>
<b>This decision applies to (sector):</b>	Transpower

*We have made an implementation change for this decision*

238. Our decision is to make an implementation change in respect of IM decision CC16.

239. The change is to use a fixed linear relationship to determine the additional debt premium associated with debt issued with an original maturity term of more than five years. In doing so, we no longer include an allowance for swap costs as part of the TCSD (see IM decision CC15).

*Why we have made this change*

240. The reasons for this change are discussed in Topic paper 4: Cost of capital issues.

**Pre-review cost of capital IM decision CC17**

<b>Decision CC17</b> <b>Cost of equity in WACC estimates – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Cost of equity is estimated using the simplified Brennan-Lally CAPM as:</p> $\text{risk free rate} \times (1 - \text{investor tax rate}) + \text{equity beta} \times \text{TAMRP}$ <ul style="list-style-type: none"> <li>• the risk free rate is the same as for the cost of debt;</li> <li>• the equity beta for Transpower is 0.61, derived from: <ul style="list-style-type: none"> <li>○ an asset beta for Transpower of 0.34; and</li> <li>○ leverage of 44% for Transpower;</li> </ul> </li> <li>• the investor tax rate is the maximum prescribed investor tax rate under the PIE tax regime, which is 30% up until 30 September 2010 and 28% thereafter. Changes in the prescribed rate will flow through to future WACC estimates automatically; and</li> <li>• the TAMRP is 7.5% until 30 June 2011 and 7% thereafter. The TAMRP is expressed as a 5-year composite rate (to match the term of the regulatory period), hence the TAMRP estimated for the 5-year period which commences on 1 July 2010 is 7.1% and for the 5-year period which commences on 1 July 2011 is 7%.</li> </ul> <p>See sections 6.5, 6.6; H3, H7, H8, H10 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

*How we have changed this decision*

241. Our decision in respect of IM decision CC17 is to make changes to:

- 241.1 the equity beta estimate – we have changed this from 0.61 to 0.60;
- 241.2 the asset beta estimate – we have changed this from 0.34 to 0.35;
- 241.3 the leverage estimate – we have changed this from 44% to 42%; and
- 241.4 our approach for calculating the asset beta – we have updated the comparator sample and then estimated an average asset beta looking at four-weekly (rather than monthly) and weekly estimates over the two most recent five-year periods.

242. The TAMRP remains at 7%.

*Why we have made these changes*

243. The reasons for these changes are discussed in Topic paper 4: Cost of capital issues.

### Pre-review cost of capital IM decision CC19

<b>Decision CC19</b> <b>Cost of capital defined as estimate of WACC – Airports</b>	<b>Original 2010 decision</b> <p>The cost of capital is an estimate of firms' WACC which reflects the cost of debt and the cost of equity used to fund investment.</p> <p>In the case of airports, for ID, the Commission considers it appropriate to take a range between the 25<sup>th</sup> to 75<sup>th</sup> percentiles. In assessing profitability for the airports an appropriate starting point for any assessment is the 50<sup>th</sup> percentile (mid-point) on the range.</p> <p>See section 6.1, E1, E2 and E11 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

*How we have changed this decision*

244. Our decision is to make a change in respect of IM decision CC19.
245. The change is to remove the specific percentile range. Therefore, we will no longer publish the 25<sup>th</sup> and 75<sup>th</sup> percentiles, but instead publish the 50<sup>th</sup> percentile, together with a standard error of the WACC estimate so that any required percentile can be calculated.<sup>70</sup>
246. We have also defined two WACC percentile equivalent methodologies: one related to the forecast cost of capital and one related to forecast post-tax internal rate of return, to improve clarity.

<sup>70</sup> The standard error of the WACC is a fixed value (0.0146 for airports) in the IM determination.

*Why we have made this change*

247. The reasons for this change are discussed in Topic paper 4: Cost of capital issues.

**Pre-review cost of capital IM decision CC20**

<b>Decision CC20</b> <b>Commission to publish annual WACC estimates – Airports</b>	<b>Original 2010 decision</b> The Commission will publish annually for airports: <ul style="list-style-type: none"> <li>• a mid-point estimate of the 5-year post-tax WACC and vanilla WACC; and</li> <li>• a 25<sup>th</sup> percentile 75<sup>th</sup> percentile estimate of the 5-year post-tax WACC and vanilla WACC.</li> </ul> See section 6.7, E14 of 2010 Airports IM reasons paper: <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

*How we have changed this decision*

248. Our decision is to make a change in respect of IM decision CC20.

249. We will no longer publish a 25<sup>th</sup> and 75<sup>th</sup> WACC percentile estimate. The change is to calculate additional mid-point WACC estimates along with standard error, for the quarters that do not align with WACC estimates calculated for ID, and to publish these additional estimates either when requested by an Airport, or after an Airport's price setting event.<sup>71</sup>

*Why we have made this change*

250. The reasons for this change are discussed in Topic paper 4: Cost of capital issues.

<sup>71</sup> The standard error of the WACC is a fixed value (0.0146 for airports) in the IM determination.

## Pre-review cost of capital IM decision CC22

<b>Decision CC22</b> <b>Cost of debt in WACC estimates – Airports</b>	<p><b>Original 2010 decision</b></p> <p>For all regulated suppliers of airport services, the cost of debt is estimated as:</p> <p style="text-align: center;"><i>risk free rate + debt premium + debt issuance costs</i></p> <ul style="list-style-type: none"> <li>• the risk free rate is estimated by the Commission as part of publishing annual WACCs for all regulated suppliers. The risk free rate is estimated from the observed market yield to maturity of benchmark vanilla New Zealand Government NZ\$ denominated nominal bonds with a term to maturity that matches the typical term of airports’ pricing agreements (5 years);</li> <li>• the debt premium is also estimated by the Commission as part of publishing annual WACCs for all regulated suppliers as the difference between the risk free rate and the yield on publicly treated corporate bonds for airports with an S&amp;P long-term credit rating of A- and a term to maturity which matches the pricing period (typically 5 years); and</li> <li>• debt issuance costs are 35 basis points (0.35%) p.a.</li> </ul> <p>See sections 6.3, E2, E4, E5, E14 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

### *How we have changed this decision*

251. Our decision in respect of IM decision CC22 is to make changes to:

251.1 the risk-free rate – we will continue to use the prevailing risk-free rate, but will use three months of data instead of one month;

251.2 the debt premium – we will now determine an ‘average debt premium’, which is an average of the debt premiums estimated over the preceding five years. We have also changed our debt premium estimation methodology to:

251.2.1 use 12 months of bond data instead of one month;

251.2.2 modify the government ownership limitation so that only bonds from 100% government owned entities are subject to the limitation; and

251.2.3 reference the ‘Nelson-Siegel-Svensson curve’ (NSS curve) as something we will consider when estimating the debt premium;

251.3 debt issuance costs – we have changed this from 35 basis points (0.35%) p.a. to 20 basis points (0.20%) p.a.; and

251.4 swap costs – we will now include an allowance for swap costs in the above value of debt issuance costs.

252. We have not changed the credit rating.

*Why we have made these changes*

253. The reasons for these changes are discussed in Topic paper 4: Cost of capital issues.

### Pre-review cost of capital IM decision CC23

<b>Decision CC23</b> <b>Term credit spread differential allowance may apply – Airports</b>	<b>Original 2010 decision</b> <p>The Airports ID Determination allows qualifying suppliers to disclose a separate allowance for the TCSD, which reflects the additional costs associated with holding a longer-term debt portfolio. The TCSD is used to adjust cash flows in ID regulation. Qualifying suppliers are suppliers with a debt portfolio which has a weighted average original tenor debt portfolio which exceeds the pricing period (typically 5 years).</p> <p>See sections 6.1, 6.3, E6 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

*How we have changed this decision*

254. Our decision in respect of IM decision CC23 is to remove the TCSD allowance.

255. Because the TCSD allowance was given effect through the Airports ID Determination in the defined term ‘allowance for long term credit spread’ (rather than in the Airports IMs), we have given effect to this decision by removing this term from the Airports ID Determination.<sup>72</sup>

*Why we have made this change*

256. The reasons for this change are discussed in Topic paper 4: Cost of capital issues.

<sup>72</sup> As explained in our Topic paper 5: Airports profitability assessment, the changes to the Airports ID Determination, published alongside the IM review decision, are only *ex-ante* amendments. Amendments to *ex-post* disclosures will be considered as part of a separate process.

## Pre-review cost of capital IM decision CC24

<b>Decision CC24</b> <b>Cost of equity in WACC estimates – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Cost of equity is estimated using the simplified Brennan-Lally CAPM as:</p> $\text{risk free rate} \times (1 - \text{investor tax rate}) + \text{equity beta} \times \text{TAMRP}$ <ul style="list-style-type: none"> <li>• the risk free rate is the same as for the cost of debt;</li> <li>• the equity beta for airports is 0.72, derived from: <ul style="list-style-type: none"> <li>○ an asset beta for airports of 0.60; and</li> <li>○ leverage of 17%;</li> </ul> </li> <li>• the investor tax rate is the maximum prescribed investor tax rate under the PIE tax regime, which is 30% until 30 September 2010 and 28% thereafter. Changes in the prescribed rate will flow through to future WACC estimates automatically; and</li> <li>• the TAMRP is 7.5% until 30 June 2011 and 7% thereafter. The TAMRP is expressed as a 5-year composite rate (to match the term of the pricing period), hence the TAMRP estimated for the 5-year period which commences on 1 July 2010 is 7.1% and for the 5-year period which commences on 1 July 2011 is 7%.</li> </ul> <p>See sections 6.3 to 6.6, E2 to E10 of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

### *How we have changed this decision*

257. Our decision in respect of IM decision CC24 is to make changes to:

257.1 the leverage estimate – we have changed this from 17% to 19%;

257.2 the equity beta estimate – we have changed this from 0.72 to 0.74; and

257.3 our approach for calculating the asset beta – we have updated the comparator sample and then estimated an average asset beta looking at four-weekly (rather than monthly) and weekly estimates over the two most recent five-year periods.

258. The asset beta estimate remains at 0.60.

259. The TAMRP remains at 7%.

*Why we have made these changes*

260. The reasons for these changes are discussed in Topic paper 4: Cost of capital issues.

## Chapter 7: Specification of price decisions we have changed

### Pre-review specification of price IM decision SP01

<b>Decision SP01</b> <b>Weighted average price cap applies – EDBs and GDBs</b>	<b>Original 2010 decision</b> Price for EDBs and GDBs is specified by a weighted average price cap.  See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB

#### *How we have changed this decision*

261. Our decision in respect of IM decision SP01 is to:

261.1 change the form of control for EDBs to a revenue cap, including a wash-up for over and under-recovery of revenue; and

261.2 maintain the current weighted average price cap for GDBs.<sup>73</sup>

262. Because we are moving EDBs to a revenue cap, we have decided that pre-review IM decision SP01 will no longer apply to EDBs. We further discuss our changes to the form of control for EDBs under IM decision SP02 below.

#### *Why we have made these changes*

263. The reasons for these changes are discussed in Topic paper 1: Form of control and RAB indexation.

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<sup>73</sup> In our draft decision, we proposed to change the treatment of pass-through and recoverable costs for GDBs from the current ascertainable approach to a pass-through balance approach. We no longer propose this, and the WAPC for GDBs remains unchanged. Our decision is explained in Topic paper 1: Form of control and RAB indexation.

## Pre-review specification of price IM decision SP02

<b>Decision SP02</b> <b>Weighted average price cap or total revenue cap applies – GTBs</b>	<b>Original 2010 decision</b> Price for GTBs will be specified by either a weighted average price cap or a total revenue cap.  See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	GTBs

### *How we have changed this decision*

264. Our decision is to change IM decision SP02 to remove the option within the IMs for a weighted average price cap or a lagged revenue cap for GTBs, instead specifying that the form of control for GTBs will be a ‘pure’ revenue cap with a revenue wash-up.
265. We have decided that a ‘pure’ revenue cap will also apply to EDBs.
266. Due to the similarities in the decisions for GTBs and EDBs, and as noted in IM decision SP01 above, we have addressed the form of control for EDBs under this IM decision SP02.

### *Why we have made these changes*

267. The reasons for these changes are discussed in Topic paper 1: Form of control and RAB indexation.

### *Key implementation features*

268. The common key implementation features of our decision to apply a revenue cap to EDBs and GTBs are:
- 268.1 A revenue cap on maximum revenues that may be recovered in each pricing year will be specified in the DPP or CPP determination.
- 268.2 The revenue cap will compare the forecast revenues planned to be used by the GTB or EDB in setting its prices with an allowable revenue amount to be specified by the Commission. The compliance implications, including timings for compliance reports, will be consulted on and specified through a DPP or CPP process.

- 268.3 In addition to the revenue cap noted above, we will also allow for a limit on the average price increase in each year's price setting, if determined in the relevant DPP or CPP determination.<sup>74, 75, 76</sup> The limit will be specified as an annual maximum percentage increase in forecast allowable revenue as a function of demand for a pricing year. The function of demand will be expressed as a function of one or more units of demand that are determined in a DPP or CPP determination. We note that for GTBs the limit on the average price increase would not apply to prices in year ending 2018 but would apply in all subsequent years.<sup>77</sup>
- 268.4 A revenue wash-up mechanism will apply for each year to wash-up the difference between actual revenue and actual allowable revenue values (ie, any over- or under-recovery of revenue), subject to a cap on the wash-up amount, where the implementation details will be specified in the DPP or CPP determination. Suppliers will be able to recover pass through costs and recoverable costs even if the cap on the wash-up amount binds.<sup>78</sup>
- 268.5 Any wash-up amounts calculated will be carried forward in a wash-up account and will be applied to prices in the next applicable year. Interest at the 67<sup>th</sup> percentile post-tax DPP/ CPP WACC rate will apply to any balances carried forward in the account.
- 268.6 Any amounts drawn down from the wash-up account in accordance with rules to be set out in the DPP or CPP determination will be determined when setting prices and will be treated as a recoverable cost when calculating the wash-up amount (see IM decisions SP05 for EDBs and SP07 for GTBs).

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<sup>74</sup> We consider that units of demand might change with the replacement of the current Maui Pipeline Operating Code and the Vector Transmission Code with a single operating code. We note that one way of dealing with this might be to use provisions under s 55l (3) if those provisions were to apply.

<sup>75</sup> Vector opposed the limit on average price increases, suggesting that this feature of the wash-up mechanism may mean that increased costs from the TPM review may never be recovered as a result of a too narrowly specified cap. We note that the EDB DPP will consult on the implementation of this cap and will take into account the ability to recover a wash up amount. Vector "Vector submission on the draft amended input methodologies determinations" (3 November 2016), para 19.

<sup>76</sup> ENA suggested that the s52P DPP/ CPP determination should specify the price limit as a direct percentage. If the ENA is suggesting we should put a limit on the increase of individual prices then we note that we do not specify limits on individual prices. There would also be an issue with limiting the percentage increase in an individual price when the type of price did not exist in the previous year. ENA "Input methodologies review: Technical consultation update paper – Submission to the Commerce Commission" (3 November 2016), p. 11.

<sup>77</sup> In response to ENA's submission on the technical consultation update paper. ENA "Input methodologies review: Technical consultation update paper – Submission to the Commerce Commission" (3 November 2016).

<sup>78</sup> The wash-up amount cap is set at 20% of net allowable revenue as specified in a DPP or CPP determination. This feature is explained further in Topic paper 1 – Form of control and RAB indexation.

269. For EDBs only, we have also decided that a cap will apply to the cumulative amount that an EDB may recover in the revenue wash-up process when the EDB has intentionally and voluntarily undercharged its revenues relative to the amount allowed in the DPP or CPP. The cap will be specified by the Commission in an EDB DPP or CPP determination.
270. A more detailed description and the reasons for these and other features of the revenue cap are set out in Topic paper 1: Form of control and RAB indexation. Attachment D also provides an illustrative example of the price setting, compliance assessment, and wash-up processes under a revenue cap.
271. In February 2017, we will publish our Gas DPP draft decision paper which will discuss further the proposed implementation details of how our decisions on the form of control will take effect at the next gas reset.
272. The practical application of these common IM features can be seen in the 'Specification of price' subpart of Part 3 of the respective EDB and GTB IM amendment determinations that we have published with this report.<sup>79</sup>

*We have also made consequential implementation changes*

273. We have made the following consequential implementation changes for this IM decision:
- 273.1 Because our decision is to move away from allowing the option of a lagged quantity revenue cap for GTBs, the revenue-setting formula in the GTB CPP IMs has been adjusted to remove references to the  $\Delta Q$  factor.<sup>80</sup>
- 273.2 There are consequential drafting amendments to the GTB and EDB IM Determinations to implement our decision to specify revenue caps. These include, for example:
- 273.2.1 removal of the specification of the forecast weighted average growth in quantities and how this information must be presented and verified in a CPP proposal;

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<sup>79</sup> ENA suggested some drafting changes which we have considered, some of which we have included in the IM determinations. We also considered ENA's comment suggesting some restructuring of the clauses but we have decided that the current structure of the determinations is appropriate. ENA also suggested that we make the IM clause 3.1.1(4) more specific by changing the word 'includes' to 'sum of' – we note the IM is focused on the principles and the DPP will include the detail so we consider the word 'includes' to be suitable for the IMs. ENA "Input methodologies review: Technical consultation update paper – Submission to the Commerce Commission" (3 November 2016).

<sup>80</sup> Commerce Commission "Input methodologies review draft decisions: Topic paper 2 – CPP requirements" (16 June 2016), Attachment B, IM decision CP28.

- 273.2.2 in the case of EDBs, the removal of the ‘pass-through balance’ approach (because this approach would effectively be applied in a similar way through the revenue wash-up mechanism); and
- 273.2.3 the removal of ‘posted’ from the definition of ‘prices’ in the EDB IM.<sup>81</sup>

### Pre-review specification of price IM decision SP03

<b>Decision SP03</b> <b>Pass-through costs – EDBs and GDBs</b>	<p><b>Original 2010 decision</b></p> <p>The IMs include a list of pass-through costs and a process for adding new pass-through costs.</p> <p>Pass-through costs includes local authority rates and regulatory levies.</p> <p>See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision – EDBs only</b></p> <p>This amendment applies to the IMs that apply for the specification of price for both DPPs and CPPs, and took effect from 1 April 2015, which corresponded with the start of the next DPP regulatory period.</p> <p>This amendment limits the risk of under- or over-recovery of pass-through and recoverable costs arising from uncertainty associated with forecasting.</p> <p>The amendment achieves this by limiting the calculation of allowable notional revenue and notional revenue for the weighted average price cap to ‘distribution prices’, which is defined as excluding pass-through and recoverable costs.</p> <p>The DPP determination includes provisions relating to demonstrating the recovery of pass-through and recoverable costs.</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB

<sup>81</sup> Submitters questioned why we proposed to remove the word ‘posted’. We have removed the word ‘posted’ because if posted is taken to mean ‘published’ then we note that prices for non standard contracts are not generally published. See for example: Powerco "Submission on input methodologies review: Technical consultation update paper" (3 November 2016), p. 13.

*How we have changed this decision*

274. Our decision is to change IM decision SP03 to extend the range of pass-through costs.
275. We have made two changes:
- 275.1 to allow criteria based pass-through costs to be specified in a DPP determination or CPP determination at the time the DPP or CPP is set, as well as during the regulatory period; and
- 275.2 to provide for adding any type of cost, which meets the pass-through cost criteria in the IMs, to potentially be specified as a pass-through cost in a DPP determination, rather than just levies.
276. These changes apply to EDBs and GDBs under this IM decision SP03 and to GTBs under IM decision SP04 (see below).

*Why we have made these changes*

277. The reasons for these changes are discussed in Topic paper 2: CPP requirements.

**Pre-review specification of price IM decision SP04**

<b>Decision SP04</b> <b>Pass-through costs – GTBs</b>  <b>(original 2010 decision amended)</b>	<p><b>Original 2010 decision</b></p> <p>The IMs include a list of pass-through costs and a process for adding new pass-through costs.</p> <p>Pass-through costs includes local authority rates and regulatory levies.</p> <p>See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2013 amendment to this decision</b></p> <p>We amended the IMs to make changes to provisions that will apply to the DPPs for suppliers of gas pipeline services.</p> <p>The definition of pass-through costs for gas transmission services was revised to allow the pass-through of Electricity and Gas Complaints Commission levies.</p> <p><a href="#">Amendments to input methodologies for gas distribution and transmission services: Reasons paper (26 February 2013)</a></p>
<b>This original decision applies to (sector):</b>	GTBs

*How we have changed this decision*

278. Our decision is to change IM decision SP04 to widen the criteria-based pass-through costs consistent with the change made to IM decision SP03.

*Why we have made these changes*

279. The reasons for these changes are discussed in Topic paper 2: CPP requirements.

## Pre-review specification of price IM decision SP05

<p><b>Decision SP05</b></p> <p><b>Recoverable costs – EDBs</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Recoverable costs include costs associated with a CPP application; the net incremental carry forward amount under IRIS; claw-back applied by the Commission; transmission charges; system operator charges; new investment contract charges; and avoided transmission charges.</p> <p>See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>The amendment changes the definitions in the general provisions of the IMs, and the IMs that apply to the specification of price for both DPPs and CPPs.</p> <p>It came into effect on 1 April 2015, which corresponded with the start of the next DPP regulatory period:</p> <p>This amendment introduces a recoverable cost relating to the revenue-linked quality incentive scheme for both System Average Interruption Duration Index (<b>SAIDI</b>) and System Average Interruption Frequency Index (<b>SAIFI</b>) reliability targets under s 53M(2) of the Act.</p> <p>Individual SAIDI and SAIFI targets, associated caps and collars, and a distributor-specific incentive rate, for each disclosure year are now specified in the DPP determination. EDBs now calculate a financial reward or penalty using the formula set out in the DPP determination, and apply this as a recoverable cost, ie, either a positive or negative amount.</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p> <p><b>2014 amendment to this decision (2)</b></p> <p>The amendment changes the definitions in the general provisions of the IMs, and the IMs that apply for the specification of price for both DPPs and CPPs.</p> <p>It took effect from 1 April 2015, which corresponded with the start of the next DPP regulatory period.</p> <p>This amendment introduces a recoverable cost relating to the financial incentives to compensate EDBs for revenue foregone because of energy efficiency and demand side management initiatives that are specified in the DPP determination.</p>
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EDBs can now calculate an amount that they consider demonstrates revenue foregone because of energy efficiency and demand side management initiatives, and apply this as a recoverable cost.

This recoverable cost will require approval by the Commission. The requirement to obtain the Commission's approval for charges payable by an electricity distributor to Transpower New Zealand Limited in respect of a new investment contract has been removed. The approval process will be set out in the DPP or CPP determination for the relevant regulatory period.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

### **2014 amendment to this decision (3)**

The amendment took effect from 1 April 2015, which corresponded to the start of the next DPP regulatory period.

This amendment introduces a recoverable cost that 'washes up' for the revenue impact of capex forecast for the year (or years) prior to the resetting of prices under a DPP determination.

The amendment changes the definitions in the general provisions of the IMs, and the IMs that apply for the specification of price for both DPPs and CPPs. The objective of the wash-up is to place EDBs in approximately the same position as that in which the value of the RAB was known at the commencement of the regulatory period at the time prices were reset.

The amendment provides that EDBs must calculate a 'capex wash-up adjustment', and apportion this as a recoverable cost evenly over each disclosure year of a DPP regulatory period, other than the first year. The apportioned amounts are adjusted for the cost of debt to reflect the time value of money.

The 'capex wash-up adjustment' is specified as:

[T]he present value of the difference in the series of building block allowable revenues before tax for a default price-quality path regulatory period from adopting actual values of commissioned assets instead of the forecast commissioned assets applied by the Commission in the year (or years) preceding the regulatory period when setting prices.

Distributors must also use the actual value of depreciation for the relevant preceding year (or years) for those newly commissioned assets. Where only one year of forecast commissioned asset values is involved then actual depreciation will be nil because the IMs do not permit depreciation to be calculated for newly commissioned assets in their year of commissioning.

The present value is determined using a discount rate equal to the WACC used by the Commission in setting prices for the current DPP regulatory period.

The building blocks allowable revenue before tax for the regulatory period must be calculated using the same methodology that was applied by the Commission in setting starting prices. This includes using all of the same financial inputs for the forecast years prior to the regulatory period (with the exception of commissioned assets and depreciation).

The actual values of commissioned assets will flow through to affect the calculation of building blocks allowable revenues before tax for the regulatory period other than the return on and of capital, including forecast revaluations and most aspects of the tax regulatory allowance.

The actual values of commissioned assets and depreciation will be available from EDBs' ID values calculated under Part 2 of the IMs.

The Commission made spreadsheets available to EDBs to assist with the necessary wash-up calculations.

In most cases the 'wash-up' would be expected to apply in respect of the disclosure year immediately prior to the regulatory period for which prices are reset (eg, the 2015 disclosure year for the 2016-2020 DPP regulatory period). However, when setting future price-quality paths it is possible that more than one year of forecast capex may be relied on to effectively construct the opening regulatory asset value at the commencement of a regulatory period. The amendment caters for these multi-year situations.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

#### **2014 amendment to this decision (4)**

The amendment took effect from 1 April 2015, which corresponded to the start of the next DPP regulatory period.

This amendment introduces a recoverable cost for the 'wash-up' of transmission asset purchases that are forecast to be completed prior to a price reset, but which are not concluded.

The Commission will identify in the relevant DPP or CPP determination the present value of the amount of revenues resulting from the additional expenditure forecast to be incurred during the regulatory period relating to transmission asset purchases forecast to occur prior to the regulatory period. Affected EDBs will then know in advance the amount of the wash-up adjustment that must be made if the purchase is not completed.

The amendment provides that a 'transmission asset wash-up adjustment' must be calculated by an electricity distributor for each disclosure year of a DPP regulatory period other than the first year. The adjustment is then applied as a recoverable cost. This recoverable cost, which is a negative amount, is effectively spread equally over the regulatory period, adjusted for the cost of debt.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

**2014 amendment to this decision (5)**

This amendment took effect from 1 April 2015, which corresponded with the start of the next DPP regulatory period.

The amendment provides that a 'transmission asset wash-up adjustment' must be calculated by an electricity distributor for each disclosure year of a DPP regulatory period other than the first year. The adjustment is then applied as a recoverable cost. This recoverable cost, which is a negative amount, is effectively spread equally over the regulatory period, adjusted for the cost of debt.

This amendment introduces a recoverable cost to provide for the recovery of levies or other charges, revenues, or costs associated with any requirements in the Electricity Industry Participation Code 2010 relating to extended reserves that may be implemented during a regulatory period. EDBs can calculate amounts relating to extended reserves, and apply this as a recoverable cost, which can be a positive or negative amount.

This recoverable cost will require approval by the Commission. The approval process will be specified for each regulatory period in a DPP or CPP determination. The Commission's approval of this recoverable cost will have regard to any stated policy intent by the Electricity Authority on whether:

- compensation payments to be made by a distributor would be expected to be treated as negative recoverable costs; or
- revenues to be received by a distributor would be expected to be treated as unregulated income.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

**2014 amendment to this decision (6)**

The amendment took effect from 1 April 2015, which corresponds to the start of the next DPP regulatory period.

This amendment allows for the recovery of prudent expenditure incurred in response to a catastrophic event, prior to any reconsideration of a price-quality path taking effect. The Commission will specify the amount that can be recovered as a recoverable cost by amending the relevant DPP or CPP determination issued in response to a catastrophic event.

The recoverable cost amount covers the additional net costs prudently incurred by a distributor in its response to a catastrophic event (ie, costs that are not provided for in a DPP or CPP):

- It includes unrecovered pass-through or recoverable costs, and costs related to the financial impact of a catastrophic event on a quality incentive scheme; and
- It excludes any foregone revenue due to the impact of a catastrophic event.

This amendment is substantively the same as that included in the variation to the specification of price IM agreed with Orion New Zealand for its CPP in the event of the path being reopened for another catastrophic event.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

#### **2014 amendment to this decision (7)**

This amendment applies to the IMs that apply for the specification of price for both default and CPPs, and took effect from 1 April 2015, which corresponds to the start of the next DPP regulatory period.

This amendment covers the additional net financial impact due to price path reconsideration events, other than a catastrophic event. It allows compensation for EDBs or consumers of any additional net costs associated with the impact of price path reconsideration events, where those costs are incurred prior to any reconsideration of the price-quality path taking effect.

The Commission will specify the amount that can be recovered as a recoverable cost in the relevant DPP or CPP determination issued following a price path reconsideration event. The recoverable cost can be a positive or negative amount.

This recoverable cost amount covers the additional net financial impact prudently incurred by a distributor as a result of a legislative or regulatory change event, or amounts to mitigate the effect of an error or provision of false or misleading information. It covers the period from the date of the event (for a change event) or from the start of the existing regulatory period (for an error or false information).

Amounts related to the financial impact of a price path reconsideration event on a quality incentive scheme are included, as well as any foregone revenue.

[Input methodology amendments for electricity distribution services: Default price-quality paths \(Reasons paper\) \(27 November 2014\)](#)

	<p><b>2014 amendment to this decision (8)</b></p> <p>This amendment applies to the IMs that apply for the specification of price for both default and CPPs, and took effect from 1 April 2015, which corresponds to the start of the next DPP regulatory period.</p> <p>This amendment modifies the existing treatment of avoided transmission charges associated with distributed generation to allow any changes implemented in accordance with the Electricity Act 2010 to be accommodated.</p> <p>The addition of a new recoverable costs term means that we can be flexible in the event of any changes to the Electricity Authority's Electricity Industry Participation Code regarding avoided transmission charges associated with distributed generation.</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p> <p><b>2014 amendment to this decision (9)</b></p> <p>This amendment applies to the IMs that apply for the specification of price for both default and CPPs, and took effect from 1 April 2015, which corresponds to the start of the next DPP regulatory period.</p> <p>This amendment limits the risk of under- or over-recovery of pass-through and recoverable costs arising from uncertainty associated with forecasting.</p> <p>The amendment achieves this by limiting the calculation of allowable notional revenue and notional revenue for the weighted average price cap to 'distribution prices', which is defined as excluding pass-through and recoverable costs.</p> <p>The DPP determination includes provisions relating to demonstrating the recovery of pass-through and recoverable costs.</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>EDBs</p>

*How and why we have changed this decision*

280. Our decision is to change IM decision SP05 to add two new recoverable costs:

- 280.1 as discussed in the reasons for change in Topic paper 1: Form of control and RAB indexation, we have introduced a recoverable cost for the revenue wash-up draw down amount; and
- 280.2 as discussed in the reasons for change in Topic paper 2: CPP requirements, we have introduced a new recoverable cost to allow suppliers to recover prudently incurred expenditure in response to an urgent project ('urgent project allowance').

Draw down of wash-up account balance

281. A new class of recoverable cost is required for our change to apply a revenue wash-up mechanism to GTBs and EDBs (see IM decision SP02).
282. The key implementation features of the revenue wash-up mechanism and the resulting requirements for recognition of the recoverable cost in revenue are for an EDB to:
- 282.1 carry out the revenue wash-up calculation for each year (as described in IM decision SP02);
  - 282.2 maintain a wash-up account to record wash-up amounts and changes to the balance (positive or negative);
  - 282.3 record draw-down amounts in the wash-up account that will be applied in the calculation of revenue and prices in a later year; and
  - 282.4 record in the wash-up account the time value of money calculated at the 67<sup>th</sup> percentile post-tax WACC rate on the balance in the wash-up account as set out in a DPP or CPP determination.
283. The common features for EDBs and GTBs calculating the wash-ups and making draw-downs from the wash-up account will be:
- 283.1 The wash-up account will record actual allowable revenue less actual revenue less revenue foregone for the pricing year, whether positive or negative.
  - 283.2 The calculation of the net allowable revenue (ie, essentially a trued up revenue cap at the time of the revenue wash-up) will use the same X factor as used when setting the forecast net allowable revenue at the time prices are set.
  - 283.3 The calculation of both forecast and actual values will include the relevant values for pass-through costs and recoverable costs, so that these will effectively get washed up in the calculations.
  - 283.4 The calculation of actual revenue for the wash-up will use the same prices as used at the time prices are set for the purpose of testing compliance with the revenue cap.
  - 283.5 The total revenues used for the revenue wash-up will be based on actual quantities supplied, and will include the sum of other regulated income which, in the case of GTBs, will include the proceeds of capacity auctions.

- 283.6 Any pass-through balance from the current regulatory period can be recovered in the next DPP period.<sup>82</sup>
- 283.7 A forecast CPI and an X factor will be used to set the price path for the regulatory period. At the time of the wash-up the actual allowable revenue will be adjusted to reflect a price path based on the actual CPI and the same X factor.
- 283.8 The wash-up amount will be capped to reflect a sharing of risk between suppliers and consumers when the quantities of services provided are significantly lower than the forecast quantities. A cap of 20% of a net allowable revenue amount would in effect apply (this is specified in the IM determinations).<sup>83</sup> Other implementation details for this cap will be specified in the DPP or CPP determinations.<sup>84</sup>
- 283.9 The balance in the wash-up account will roll forward from year to year (or between regulatory periods where applicable), taking into account wash-up entries, draw-down amounts, and the time value of money calculated on the balance in the account.
- 283.10 When the wash-up balance is in favour of consumers, it is mandatory that the balance must be drawn down as soon as possible.

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<sup>82</sup> ENA "Input methodologies review: Technical consultation update paper – Submission to the Commerce Commission" (3 November 2016), p. 13; Orion submission on IM review technical consultation and on the ENA letter regarding live-line work "Submission on input methodologies review technical consultation" (3 November 2016), p. 2-3; Vector "Vector submission on the draft amended input methodologies determinations" (3 November 2016), p. 9.

<sup>83</sup> Submissions on our technical consultation update paper commented that the cap on the wash up amount should not apply but that if it does it should be based on forecast allowable revenue rather than forecast net allowable revenue. The cap will be based on net allowable revenue as specified in a DPP or CPP determination. We are maintaining an approach based on net allowable revenue rather than the gross amount of allowable revenue, as this is required to ensure that pass through costs and recoverable costs continue to be fully passed through when the cap binds. ENA "Input methodologies review: Technical consultation update paper – Submission to the Commerce Commission" (3 November 2016), p. 10-11; First Gas "Submission on Input methodologies review technical consultation update paper" (3 November 2016), p.3; and Orion submission on IM review technical consultation and on the ENA letter regarding live-line work "Submission on input methodologies review technical consultation" (3 November 2016), p. 2-3.

<sup>84</sup> In our draft decision we proposed including a cap and collar on the drawdown amount mechanism. In response to submissions we removed this feature to reduce complexity of the mechanism. See for example: See for example: Wellington Electricity "Input methodologies review: Response to draft decisions" (4 August 2016) p. 2.

- 283.11 Some submitters on our technical consultation update paper questioned what will happen to any pass-through balance that is carried forward over from the current DPP regulatory period when the new revenue cap begins. In response to that query, we note that such costs will be recovered during the new regulatory period by an appropriate recognition of such amounts in the balance of the wash-up account for the new regulatory period plus any related time value of money adjustment provided for in a DPP or CPP determination.<sup>85</sup>
284. In addition to the common features for EDBs and GTBs, the following will apply to EDBs only:
- 284.1 A large credit balance may build up in the over/under balance in the wash-up account from EDBs intentionally undercharging. A limit may apply to the amount that an EDB may recover in the revenue wash-up process when the EDB has intentionally and voluntarily undercharged its revenues relative to the amount allowed in the DPP or CPP. Any applicable limit will be specified by the Commission in an EDB DPP or CPP determination.
- 284.2 Under this mechanism, undercharging amounts would be rolled forward in the wash-up account if the EDB does not draw them down into revenues, but the ability to recover the excess over the cap will be permanently forgone.
285. Further description, and the reasons for these and other features of the revenue wash-up mechanism, are set out in Topic paper 1: Form of control and RAB indexation. A description of the implementation of our decisions for GTBs (and key aspects which will also apply to EDBs at the later EDB DPP reset or to an EDB CPP after implementation) will be described in the Gas DPP draft decision paper, which we anticipate publishing in February 2017.
286. The practical implementation of these proposed features can also be seen in the 'Specification of price' subpart of Part 3 of the respective EDB and GTB IM amendments determinations that we have published with this report.

#### Urgent project allowance

287. As discussed in Topic paper 2: CPP requirements, we have introduced a new recoverable cost to allow suppliers to recover prudently incurred expenditure in response to an urgent project. This decision also applies to GDBs (IM decision SP06) and GTBs (IM decision SP07). Our reasons for this change are discussed in Topic paper 2: CPP requirements.

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<sup>85</sup> Because EDBs are subject to the 'pass-through balance' approach, it is possible that an EDB will have unrecovered pass-through costs or recoverable costs relating to the period prior to the revenue cap and wash-up mechanism going into effect. ENA "Input methodologies review: Technical consultation update paper – Submission to the Commerce Commission" (3 November 2016), p. 13.

### Capex wash-up mechanism for CPPs

288. We have made a change to the recoverable costs provisions to extend the capex wash-up mechanism, which we introduced in 2014 for DPPs, to CPPs.<sup>86</sup> This is intended to operate and achieve the same outcomes as the DPP capex wash-up mechanism.

### Energy efficiency and demand-side management incentive allowance

289. As we have implemented a revenue cap for EDBs, there is no longer a need to provide an energy efficiency and demand-side management incentive allowance, as EDBs will no longer face lower revenues if the volume of energy used by their consumers decreases.

### Distributed Generation Pricing Principles

290. In response to our draft decision some submitters suggested that we should consider whether a change to the Distributed Generation Pricing Principles (DGPP) requires an amendment to the IMs.<sup>87</sup> We note that the EA made its decision on the DGPP on 6 December 2016, and therefore any possible implications of this decision on the IMs have not been able to be properly considered and consulted on as part of this IM review. Separate to the IM review, we will consider the implications of this decision and will make any required changes to the IMs in the future if necessary.

### Review of recoverable costs

291. We have removed the words “non-exempt” from clause 3.1.3(1)(b) of the EDB IM Determination. This is to ensure comparability of the measurement of the return on investment for ID purposes between exempt and non-exempt EDBs.

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<sup>86</sup> See the 2014 amendment to this decision (3), above.

<sup>87</sup> See for example, Network Tasman "Submission on the input methodologies review consultation" (4 August 2016), p.4.

## Pre-review specification of price IM decision SP06

<p><b>Decision SP06</b></p> <p><b>Recoverable costs – GDBs</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Recoverable costs include costs associated with a CPP application; the net incremental carry forward amount under IRIS; and claw-back applied by the Commission.</p> <p>See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2013 amendment to this decision</b></p> <p>Amended the IMs to make changes to provisions that will apply to the DPPs for suppliers of gas pipeline services.</p> <p>The definition of recoverable costs was amended to refer to the recovery of balancing gas costs or credits from welded parties, as well as shippers, on a supplier’s network. Welded parties are defined as those entities having an interconnection agreement with the GTB.</p> <p><a href="#">Amendments to input methodologies for gas distribution and transmission services: Reasons paper (26 February 2013)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>GDBs</p>

### *How we have changed this decision*

292. Our decision is to change IM decision SP06 to add:

292.1 a 'wash-up' of forecast capex for the year (or years) prior to the setting of a DPP or CPP, consistent with our 2014 decision for EDBs DPPs, and consistent with our changes for GTBs;<sup>88</sup>

292.2 an allowance for the recovery of prudent expenditure incurred in response to a catastrophic event, consistent with our 2014 decision for EDBs and consistent with GTBs;<sup>89</sup> and

<sup>88</sup> Commerce Commission “Input methodology amendments for electricity distribution services: Default price-quality paths” (27 November 2014).

<sup>89</sup> Commerce Commission “Input methodology amendments for electricity distribution services: Default price-quality paths” (27 November 2014).

292.3 as discussed in the reasons for change in Topic paper 2: CPP requirements, a new recoverable cost allowance to allow suppliers to recover prudently incurred expenditure in response to an urgent project ('urgent project allowance').

*Why we have made these changes*

'Wash-up' of forecast capex

293. We made an amendment to introduce a capex wash-up mechanism for EDBs DPPs in November 2014.<sup>90</sup> We have amended the IMs so that the mechanism will now apply:

293.1 to GDB DPPs – to align with our pre-review treatment of EDBs;<sup>91</sup> and

293.2 to GDB CPPs.<sup>92</sup>

294. This recoverable cost is a 'wash-up' for the revenue impact of capex that is forecast for the year (or years) prior to the resetting of prices under a DPP determination. The objective of the wash-up is to place GDBs in approximately the same position as that in which the value of the RAB was known at the commencement of the regulatory period when prices were reset.

295. The capex wash-up adjusts for the difference between:

295.1 DPP or CPP we set, based on a forecast opening RAB for the period; and

295.2 the DPP or CPP we would have set if the actual opening RAB was available.

296. The difference between these two situations is caused by the Commission having to use a forecast value of commissioned assets for the final year (or years) before a DPP or CPP reset.

297. The wash-up amount equals the difference in BBAR before tax in the two situations described above. The difference is calculated in present-value terms for the whole of the regulatory period.

298. The BBAR before tax for the regulatory period is calculated using the same methodology that was applied by the Commission in setting starting prices. This includes using all of the same financial inputs for the forecast years prior to the regulatory period (with the exception of commissioned assets and depreciation).

299. The actual values of commissioned assets and depreciation are available from GDB ID values calculated under Part 2 of the IMs.

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<sup>90</sup> Commerce Commission "Input methodology amendments for electricity distribution services: Default price-quality paths" (27 November 2014), para 7.1-7.15.

<sup>91</sup> We have also made this change for GTB DPPs under IM decision SP07.

<sup>92</sup> We have also made this change for EDB CPPs under IM decision SP05 and GTB CPPs under IM decision SP07.

300. By setting out the method for calculating the difference between the forecast and actual return on and return of commissioned assets, GDBs are able to calculate the adjustment themselves.

Allowing for the recovery of prudent expenditure incurred in response to a catastrophic event

301. We made this amendment for EDBs in November 2014.<sup>93</sup> The amendment now aligns the treatment for GDBs with the treatment for EDBs.
302. Defining the share of risks between GDBs and consumers prior to any future catastrophic event provides greater certainty to all parties.
303. The recoverable cost helps to provide an appropriate level of compensation to GDBs for expenditure incurred after the event following a catastrophic event and prior to any reconsideration by us taking place.
304. We consider that in catastrophic circumstances, providing *ex-post* compensation for additional net costs strengthens the existing incentives that the GDB has to restore supply. Consumers now benefit from expenditure to repair the gas distribution network because it helps to ensure that demand is able to be met.
305. This recoverable cost allows for recovery of prudent expenditure incurred in response to a catastrophic event, prior to any reconsideration of a price-quality path taking effect. We will specify the amount that can be recovered as a recoverable cost by amending the DPP determination or by including the amount in any CPP determination issued in response to the catastrophic event.
306. The recoverable cost amount covers the additional net costs prudently incurred by a GDB in its response to a catastrophic event (ie, costs that are not already provided for in a DPP or CPP). However, no additional compensation (either *ex-ante* or *ex-post*) is provided for lower-than-forecast revenues due to future catastrophic events.

Urgent project allowance

307. As discussed in Topic paper 2: CPP requirements, we have introduced a new recoverable cost allowance to allow suppliers to recover prudently incurred expenditure in response to an urgent project. This decision also applies to GTBs (IM decision SP07) and EDBs (IM decision SP05). Our reasons for this change are discussed in Topic paper 2: CPP requirements.

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<sup>93</sup> Commerce Commission “Input methodology amendments for electricity distribution services: Default price-quality paths” (27 November 2014), para 11.1-11.30.

## Pre-review specification of price IM decision SP07

<b>Decision SP07</b> <b>Recoverable costs – GTBs</b>	<b>Original 2010 decision</b> Recoverable costs include costs associated with a CPP application; the net incremental carry forward amount under IRIS; claw-back applied by the Commission; and costs or credits associated with the sale or purchase of balancing gas.  See section 8.3 and Appendix J, section J2 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	GTBs

### *How we have changed this decision*

308. Our decision is to change IM decision SP07 to add:
- 308.1 as discussed in the reasons for change in Topic paper 1: Form of control and RAB indexation, a recoverable cost for the draw-down of the revenue cap wash-up balance;
  - 308.2 a 'wash-up' of forecast capex for the year (or years) prior to the setting of a DPP determination or CPP determination, consistent with our 2014 decision (for DPPs) for EDBs and consistent with GDBs;
  - 308.3 an allowance for the recovery of prudent expenditure incurred in response to a catastrophic event, consistent with our 2014 decision for EDBs and consistent with GDBs;
  - 308.4 a recoverable cost for compressor fuel gas; and
  - 308.5 as discussed in the reasons for change in Topic paper 2: CPP requirements, a new recoverable cost allowance to allow suppliers to recover prudently incurred expenditure in response to an urgent project ('urgent project allowance').
309. We have also made a change that clarifies the treatment of balancing gas as a recoverable cost.
310. Finally, this section discusses MDL's proposed extension to recoverable costs, which we have not implemented.<sup>94</sup>

<sup>94</sup> MDL, Untitled submission on problem definition paper (21 August 2015), p. 3-4.

*Why we have made these changes*

Draw down of wash-up account balance

311. A new class of recoverable cost has been created for our decision to apply a revenue wash-up mechanism to GTBs (and EDBs). The common key implementation features of the revenue wash-up mechanism and the resulting requirements for recognition of the recoverable cost in revenue are described in detail for EDBs in IM decision SP05 above.
312. Further description and the reasons for this change are described in Topic paper 1: Form of control and RAB indexation. In February 2017, we will publish our Gas DPP draft decision paper which will discuss further the implementation details of how we propose the form of control will take effect at the next reset.
313. The practical application of this decision can also be seen in the ‘Specification of price’ subpart of Part 3 of the GTB IM amendments determination that we have published alongside this report.

‘Wash-up’ of forecast capex

314. This change aligns the treatment of GTBs with GDBs and EDBs (see our reasons in more detail under IM decision SP06 above). We made this amendment for EDBs’ DPPs in November 2014 and extended it to CPPs as part of this decision as well.

Allowing for the recovery of prudent expenditure incurred in response to a catastrophic event

315. This change aligns the treatment of GTBs with GDBs (see our reasons in more detail under IM decision SP06 above). We made this amendment for EDBs in November 2014.
316. This recoverable cost allows for recovery of prudent net additional expenditure incurred by a GTB in response to a catastrophic event (ie, costs that are not already provided for in a DPP or CPP price path), prior to any reconsideration of a price-quality path taking effect.
317. We will specify the amount of the recoverable cost by amending the DPP determination or include the amount in any CPP determination issued in response to the catastrophic event. Although no additional compensation for lower-than-forecast revenues due to catastrophic events is provided for through this recoverable cost, such compensation is effectively provided for GTBs through the revenue cap and revenue wash-up mechanism, subject to any cap on the wash-up amount specified in the DPP or CPP determination.

Compressor fuel gas a recoverable cost in some instances

318. Compressor fuel used in compressors on the Maui transmission system is now specified as a recoverable cost. Compressor fuel used elsewhere in the transmission system is still classified as ordinary opex.
319. We changed clause 3.1.3 so that First Gas is able to recover all compressor fuel costs related to the Mokau compressor on the Maui Pipeline through a recoverable cost.

320. We have made this change based on the submission from MDL (now a part of First Gas) which identified unequal treatment of the technically equivalent substitution of balancing gas transaction with the running of compressors.<sup>95</sup> Balancing gas was recoverable, compressor fuel was not.
321. In our draft decision, we proposed a 'least cost' test to determine whether compressor fuel used in lieu of balancing should be recoverable. First Gas submitted that in practise this test would be difficult to apply. To address this, the IMs now make a categorical distinction between compressor fuel used in compressors on the Maui transmission system (which will be recoverable) and compressor fuel used elsewhere.<sup>96</sup>
322. First Gas submitted that it is difficult to determine:
- 322.1 the circumstances in which compressor fuel is a lower cost alternative to balancing; and
- 322.2 on the non-Maui pipelines in the gas transmission system, whether compressor fuel was used for balancing reasons or for general system operation reasons.<sup>97</sup>
323. First Gas stated that the Mokau compressors for the Maui pipeline are used almost exclusively for balancing. It also stated that it intends to explore ways in which compressors could be managed more efficiently in future.<sup>98</sup>
324. We consider that this change allows flexibility to a GTB to choose the most efficient alternative (between balancing or compressor use), while at the same time providing GTBs with an incentive to make efficient use of compressors on the system as a whole.

#### Urgent project allowance

325. As discussed in Topic paper 2: CPP requirements, we have introduced a new recoverable cost allowance to allow suppliers to recover prudently incurred expenditure in response to an urgent project. This draft decision also applies to GDBs (IM decision SP06) and EDBs (IM decision SP05). Our reasons for this proposed change are discussed in Topic paper 2: CPP requirements.

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<sup>95</sup> MDL, Untitled submission on problem definition paper (21 August 2015), p. 4-6.

<sup>96</sup> First Gas "Submission on Input methodologies review draft decisions (excluding cost of capital)" (4 August 2016), p. 3.

<sup>97</sup> First Gas "Submission on Input methodologies review draft decisions (excluding cost of capital)" (4 August 2016), p. 3.

<sup>98</sup> First Gas "Submission on DPP for gas pipeline services from 1 October 2017" (4 August 2016), p. 4.

Proposed change to clarify treatment of balancing gas as a recoverable cost

326. We have clarified the definition of balancing gas as a recoverable cost. The definition now covers any cost, credit, or charge, including cash-outs. We have also removed the requirement for the Commission to approve these costs in accordance with a process to be set out in a DPP.<sup>99</sup>
327. In May 2015, we provided clarification to the GTBs and industry on the treatment of balancing gas as a recoverable cost. This was via a letter sent to the parties and published on our website.<sup>100</sup> The relevant text is:
- We consider that recoverable costs include: cash-outs under the current gas balancing regime; and daily cash-outs arising from the regime pursuant to MDL's change request.
- We consider that the relevant input methodology does not limit recoverable costs to those arising in respect of the supplier's own network. As a consequence, recoverable costs will include both cash-out costs and credits for MDL, and cash-out costs and credits for Vector.
328. MDL requested that this advice be codified in the IMs.<sup>101</sup>
329. We agree that amending the IMs to codify the clarification already provided would improve ongoing certainty.
330. The industry change that has put the different networks under common ownership is not expected to alter the conclusions in the advice provided in the letter and so does not affect the proposed IM changes:
- 330.1 a cash-out transaction would be recognised as a recoverable cost;
- 330.2 when that transaction affects another supplier's network, the other supplier may recover balancing costs relating to the other system transaction; and
- 330.3 for a consolidated supplier this should result in the balancing between systems transactions effectively cancelling out and being an internal transfer.
331. MDL also made a submission which seeks to expand the definition of recoverable costs, beyond 'cash-outs', to include all aspects of any balancing regime the GTBs have in place.<sup>102</sup>

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<sup>99</sup> These costs remain subject to the audit and certification requirements specified in a DPP.

<sup>100</sup> Commerce Commission, Letter to Maui Development Limited and Vector Limited "Recoverable costs in respect of gas balancing" (12 May 2015), available at: <http://www.comcom.govt.nz/dmsdocument/13232>.

<sup>101</sup> MDL, Untitled submission on problem definition paper (21 August 2015), p. 3.

<sup>102</sup> MDL, Untitled submission on problem definition paper (21 August 2015), p. 3-4.

332. However, our 2010 EDB GPB Reasons Paper states:<sup>103</sup>

It is not appropriate for all costs associated with balancing activities to be treated as pass-through costs, as many of these functions can reasonably be expected to be performed by a GTB as part of the regulated service.

333. Therefore, while we have clarified the definition of balancing gas costs, we have not expanded the definition of recoverable costs to include all balancing actions.

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<sup>103</sup> Commerce Commission “Input methodologies (electricity distribution and gas pipeline services) reasons paper” (22 December 2010), J2.32.

## Chapter 8: Reconsideration of the price-quality path decisions we have changed

### Pre-review reconsideration of the DPP IM decision RP01

<p><b>Decision RP01</b></p> <p><b>Reconsideration of DPP</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>For all services, a DPP may be reconsidered if a material error is discovered in the determination; or a supplier has provided false or misleading information, which the Commission has relied upon in making its determination.</p> <p>See section 8.4 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>High Court judgment in <i>Wellington International Airports Ltd and others v Commerce Commission</i> [2013] NZHC 3289 (11 December 2013) and Commerce Commission “Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court” (27 November 2014). See amended definitions of ‘catastrophic event’, ‘change event’ and clauses 4.5.1 to 4.5.5 of each of the EDB IM Determination, GDB IM Determination and GTB IM Determination:</p> <p>A DPP may be reconsidered if a catastrophic event or change event has occurred. This aligns the DPP reconsideration provisions with the CPP provisions.</p> <p><a href="#">Publication of Electricity, Gas, and Airport Input Methodology Amendments ordered by the High Court (27 November 2014)</a></p> <p><a href="#">Wellington International Airport Ltd &amp; Ors v Commerce Commission [2013] NZHC 3289 [11 December 2013]</a></p>
<p><b>This original decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

#### *How we have changed this decision*

334. Our decision is to change IM decision RP01.
335. We have changed the DPP reconsideration provisions to:

- 335.1 expand the existing DPP 'error' reopener provision for EDBs, GDBs and GTBs;
- 335.2 introduce a DPP reopener that would allow us to reconsider an EDB's quality standards, in place of the current option for EDBs to apply for a quality-only CPP; and
- 335.3 introduce a new reopener provision to allow a price-quality path to change in response to a major transaction for EDBs, GDBs and GTBs.

*Why we have made these changes*

Expanded error reopener provision

- 336. We have expanded the current error provision to address the situation where a price-quality path was set on the basis of any type of error. This could include cases where incorrect data was used in setting the DPP, or where the data was correct but was applied incorrectly.
- 337. The error provisions were previously limited to dealing with incorrect data and cannot be used in situations where, for example, data was incorrectly or mistakenly applied.
- 338. The change does not incorporate any additional new information (beyond corrections) or include information that, post determination, is subsequently considered better for setting a price-quality path.

Introduction of a quality standard reopener for EDBs

- 339. We have introduced a DPP reopener that would allow us to reconsider an EDB's quality standards, in place of the current option for EDBs to apply for a quality-only CPP. Our reasons for this change are discussed in Topic paper 2: CPP requirements.

Major transactions reopener provision

- 340. We have created a new reconsideration provision to allow us to reopen a price-quality path (or paths), if necessary, to respond to a major transaction.
- 341. In addition to provisions in the IMs that are intended to provide certainty about the treatment of amalgamations in particular (IM decisions AM01 to AM03), there are also compliance provisions in the relevant price-quality path determinations setting out how major transactions will be addressed more generally.<sup>104</sup>

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<sup>104</sup> For example, *Electricity Distribution Services Default Price-Quality Path Determination 2015* [2014] NZCC 33, Clause 10.

342. In applying these provisions to ensure price-quality paths apply as intended following a major transaction, it is possible that there may need to be a change to one or more regulated suppliers' allowable revenues and/or quality standards. The reconsideration provision would make it clear we may reopen the price-quality path, if necessary, to ensure the price-quality path(s) still apply as intended to the relevant regulated services.
343. This would not cover situations where the Commission or a supplier wanted to change the price-quality path for any reason other than responding to the new circumstances following a major transaction.
344. We consider that this reconsideration provision is necessary because there are many ways that transactions could occur, and it is not feasible to establish compliance provisions that can account for all situations. The major transactions reconsideration provision would allow us to amend the path where necessary to take account of these unforeseen situations.
345. In establishing this provision, we have included a definition of major transactions in the IM determinations based on the existing definition in relevant DPP determinations and on the definition provided in s 129 of the Companies Act 1993.
346. The reconsideration provision has the following features:
- 346.1 It can be triggered by us;
  - 346.2 It only applies to the price-quality path to the extent necessary to respond to the major transaction; and
  - 346.3 It allows us to undertake any consultation we consider appropriate in each circumstance.

## Pre-review reconsideration of the CPP IM decision RP02

<b>Decision RP02</b> <b>Reconsideration of CPP</b>	<p><b>Original 2010 decision</b></p> <p>For all services, a CPP may be reconsidered if one of the following events has occurred:</p> <ul style="list-style-type: none"> <li>• a catastrophic event, for which the costs of rectifying the impact of the event is material; or</li> <li>• a material error is discovered in the determination; or</li> <li>• a supplier has provided false or misleading information, which the Commission has relied upon in making its determination; or</li> <li>• a change in legislative or regulatory requirements that has a material impact on costs</li> </ul> <p>See section 8.4 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

### *How we have changed this decision*

347. Our decision is to change IM decision RP02.

348. We have changed the CPP reconsideration provisions to:

348.1 provide for reconsideration of a CPP where there is a DPP WACC change. This decision links with our decision to use the prevailing DPP WACC rate throughout a CPP (see IM decision CC03);

348.2 expand the scope of the existing 'error' reopener provision;

348.3 introduce a new reopener provision to allow a CPP to change in response to a major transaction for EDBs, GDBs and GTBs; and

348.4 introduce a contingent and unforeseen project reopener for EDBs and GDBs.

### *Why we have made these changes*

#### Re-opening the CPP price path to apply an updated DPP WACC rate

349. Our reasons for making this change are discussed in Topic Paper 4: Cost of capital issues.

#### Expanded error reopener provision

350. We have made this change to IM decision RP02 for the same reasons as discussed above for IM decision RP01.

Major transactions reopener provision

351. We have made this change to IM decision RP02 for the same reasons as discussed above for IM decision RP01.

Contingent and unforeseen project reopener provision

352. Our decision to introduce contingent and unforeseen project reopeners for EDBs and GDBs is explained in Chapter 3 – Topic Paper 2: CPP requirements – Improvements to the way the DPP and CPP work together.

**Pre-review reconsideration of the price-quality path IM decision RP03**

<b>Decision RP03</b> <b>Meaning of ‘material’ for purposes of reconsideration</b>	<p><b>Original 2010 decision</b></p> <p>In this context, material means that the impact of the event over the remainder of the regulatory period is at least 1% of the aggregated allowable notional revenue for the years in which the costs associated with the event are incurred.</p> <p>See section 8.4 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*How we have changed this decision*

353. We have amended IM decision RP03 in respect of the 1% materiality threshold on allowable revenue for the error reopener such that the threshold only applies to errors in allowable revenue, rather than errors that might affect other aspects of the price-quality path.

354. We have also removed the requirement to meet the 1% materiality threshold for the change event DPP and CPP reopener, in circumstances where the change event causes an IM to become unworkable – that is, incapable of being applied.

*Why we have made these changes*

355. The reasons for these changes are set out in Attachment B.

*Issues we have considered where we have not made a change*

356. ENA made a number of suggestions for changes to reopener provisions to address implementation issues relating to the Health and Safety at Work Act 2015. These are discussed in Attachment C.<sup>105</sup>

<sup>105</sup> Our explanation of the price path reopener provisions in s 53ZB of the Commerce Act are set out in Attachment C.

## Pre-review reconsideration of the price-quality path IM decision RP04

<p><b>Decision RP04</b></p> <p><b>Reconsideration for contingent or unforeseen expenditure under a CPP – GTBs</b></p>	<p><b>Original 2010 decision</b></p> <p>A GTB’s CPP may also be reconsidered if a trigger event occurs for a project on the contingent project list, or an unforeseen project has commenced or is committed to take place during a CPP regulatory period.</p> <p>The Commission has incorporated additional mechanisms for dealing with contingent or unforeseen gas transmission investments by adopting a contingent/unforeseen project approach, whereby:</p> <ul style="list-style-type: none"> <li>• the costs of particular large investments are not provided for in the <i>ex ante</i> revenue allowance where the need, timing, and/or costs of the project are uncertain or the project is unforeseen when a proposal is submitted;</li> <li>• the Commission will only reconsider the price path if the GTB satisfies the Commission that the project will proceed; and</li> <li>• the amendment to the price path will not take effect until the year in which assets associated with the project are forecast to be commissioned.</li> </ul> <p>Contingent projects are tied to a specific trigger event and forecast costs must meet a materiality threshold. A trigger event is a condition or event that (among other things) is not within the control of the GTB and would reasonably cause the GTB to undertake the project.</p> <p>The GTB must demonstrate that the assets associated with the project are likely to be commissioned during the CPP regulatory period.</p> <p>The forecast or indicative capex of the project must be at least 10 per cent of the value of the applicant’s most recently disclosed annual revenue. This is equivalent to an increase of approximately one per cent per annum of the annual allowable revenue and is consistent with the materiality threshold that forms part of the cost allocation IM.</p> <p>Proposals must include sufficient information to enable the Commission to identify whether a project satisfies the contingent project criteria. The independent verifier will be required to provide an opinion as to whether the project satisfies the criteria.</p> <p>Projects approved as contingent projects (and the trigger events for each project) will be identified in a CPP determination. The Commission may also decide to classify other projects (than those proposed by the supplier) as contingent projects.</p> <p>The Commission considers that it is appropriate to accommodate ‘unforeseen projects’ under the contingent project mechanism if the project satisfies the following criteria:</p> <ul style="list-style-type: none"> <li>• it was unforeseeable to a prudent operator of gas transmission</li> </ul>
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	<p>services at the time it submitted its CPP proposal; and</p> <ul style="list-style-type: none"> <li>• it meets the same materiality threshold as a contingent project.</li> </ul> <p>A GTB may apply to the Commission to reconsider the price path where a trigger event has occurred or an unforeseen project has commenced or is committed to proceed during the CPP regulatory period.</p> <p>Reconsideration arising from a contingent project or unforeseen project is not an opportunity to reconsider all aspects of the original proposal. Rather it allows the Commission the opportunity to scrutinise the justification for the proposed incremental increase in forecast capex and operating expenditure (<b>opex</b>), over and above the forecast capex and opex already provided for in the MAR. Any amendment to the price path will not take effect until the year in which assets associated with the project are forecast to be commissioned.</p> <p>See sections 8.4 and 9.5 and Appendix K of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	GTBs

#### *How we have changed this decision*

357. Our decision is to extend IM decision RP04 so that it applies to EDBs and GDBs, as well as GTBs.

#### *Why we have made this change*

358. The reasons for our decision are described in Topic paper 2: CPP requirements.

359. Extending this reopener allows us to reopen the price path for EDBs and GDBs (in addition to GTBs) to build in incremental expenditure for projects where the time, scope or cost was not known at the time the CPP was set. We consider that this reopener is appropriate under a CPP as we would have already scrutinised the underlying expenditure when we initially determined the CPP, without concerns that the project may be already provided for in the path.<sup>106</sup>

<sup>106</sup> Commerce Commission “Input methodologies review draft decisions: Topic paper 2 – CPP requirements” (16 June 2016), para 109-115.

## Pre-review reconsideration of the price-quality path IM decision RP05

<p><b>Decision RP05</b>  <b>Reconsideration of IPP – Transpower</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower's IPP may be reconsidered if one of the following events has occurred:</p> <ul style="list-style-type: none"> <li>• a catastrophic event, for which the costs of rectifying the impact of the event is material; or</li> <li>• a material error is discovered in the determination; or</li> <li>• Transpower has provided false or misleading information, which the Commission has relied upon in making its determination; or</li> <li>• a change in legislative or regulatory requirements that has a material impact on Transpower's costs.</li> </ul> <p>See section 7.4 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>The amendment affects the IMs relating to individual price-quality regulation for Transpower.</p> <p>It will apply with effect from 1 July 2015, which corresponds to the commencement date of the first disclosure year for RCP2.</p> <p>We have amended the provisions relating to reconsideration of Transpower's IPP by replacing the term 'quality targets' with terminology that reflects the quality standards framework applying under the Capex IM.</p> <p>The new terminology is that of 'revenue-linked grid output measures', involving 'grid outputs', 'grid output targets', 'caps', 'collars' and 'grid output incentive rates', whereas the previous terminology reflected the quality targets set in the 2010 IPP.</p> <p>The change allows the revenue-linked grid output measures specified in an IPP determination to be amended following a catastrophic event, error, or change event, as provided for in the price-quality path reconsideration provisions in the IMs.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Transpower</p>

### *How we have changed this decision*

360. Our decision is to change IM decision RP05 to expand the scope of the existing 'error' reopener provision.

361. We have also added ‘revenue-linked grid output measure’ to the error event provisions for reconsideration of the IPP.

*Why we have made this change*

362. We have made the first change to IM decision RP05 for the same reasons as for IM decision RP01.
363. The second change is to clarify that an error in the data used for a grid output measure in setting the price path is included as a type of error which allows for the reconsideration of the IPP.

**Pre-review reconsideration of the price-quality path IM decision RP06**

<b>Decision RP06</b> <b>Meaning of ‘material’ for purposes of reconsideration – Transpower</b>	<b>Original 2010 decision</b> In this context, material means that the total effect of the event on the price path is at least 1% of the aggregated forecast MARs for the years in which the costs associated with the event are incurred.  See section 7.4 of 2010 IM Transpower reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

*How we have changed this decision*

364. We have amended IM decision RP06 in respect of the 1% materiality threshold on allowable revenue for the error reopener so that the threshold only applies to errors in allowable revenue, rather than errors that might affect other aspects of the price-quality path.
365. In the case of error reopeners relating to quality standards or quality incentive measures, no threshold will apply. However, the error must relate to values rather than metrics.
366. We have also removed the requirement to meet the 1% materiality threshold for the change event DPP and CPP reopener, in circumstances where the change event causes an IM to become unworkable – that is, incapable of being applied.

*Why we have made these changes*

367. The reasons for this change are set out in Attachment B.

## Chapter 9: IRIS decisions we have changed

### Pre-review IRIS IM decision IR02

<p><b>Decision IR02</b></p> <p><b>Treatment of IRIS balances – EDBs</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>While both incremental gains and losses will be carried forward to the subsequent 5 years, only positive net balances of such gains and losses in years in the next regulatory period will be treated as recoverable costs. (ie, only net rewards will be recognised).</p> <p>See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>We put in place an incentive to control expenditure that is the same in each year of the regulatory period. Unlike the pre-existing asymmetric IRIS for opex, the revised IRIS would provide incentives that are the same in each year:</p> <ul style="list-style-type: none"> <li>• For opex, the retention period for savings and losses is 5 years following the year of the gain and loss, which is equivalent to a retention factor of around 35% for a supplier.</li> <li>• ... the strength of the incentive applying to capex can be varied relative to the incentive strength applying to opex. The choice of retention factor for capex will be decided at the time of each reset.</li> </ul> <p>In the second full year after the price-quality path starts to apply to the supplier, a one-off adjustment is made after the carry forward amounts are added together.</p> <p>The one-off adjustment in the second year is required to correct for the difference between the actual and assumed level of opex in the final year of the preceding price-quality path. This adjustment is required because the incremental change in the final year of a price-quality path is assumed to be nil.</p> <p><a href="#">Amendments to input methodologies for electricity distribution services and Transpower New Zealand: Incremental Rolling Incentive Scheme (27 November 2014)</a></p> <p><b>2015 amendment to this decision (2)</b></p> <p>We made further amendments intended to address situations in which a distributor transitions back and forth between default and CPPs.</p> <p>The situation in which a distributor transitions onto a CPP provides different incentives compared to the situations under a DPP and IPP.</p>
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	<p>After considering the options proposed by submitters we determined that retaining an IRIS and implementing the approach proposed by Powerco was most appropriate given the circumstances of a CPP as it provides the most beneficial incentives on suppliers:</p> <ul style="list-style-type: none"> <li>• In its submission, Powerco suggested an approach in which the temporary savings in the penultimate year are assumed to be the difference between forecast and actual opex in that year.</li> <li>• Under the Powerco approach, the correct adjustments are made through the baseline adjustment term for any temporary savings in the penultimate year (eg, year 4).</li> </ul> <p><a href="#">Further amendments to input methodologies for electricity distributors subject to price-quality regulation - Incremental Rolling Incentive Scheme (IRIS) (25 November 2015)</a></p>
<b>This original decision applies to (sector):</b>	EDBs

*We have made an implementation change for this decision*

368. We have changed IM decision IRO2 to amend the EDB IM ‘opex incentive amount’ calculation to fit the purpose of the ‘adjustment to the opex incentive’ by using a modified version of the ‘capex incentive adjustment’ calculation.

*Why we made this change*

369. Under the EDB IRIS, as it applied before the change, when an adjustment to the opex incentive was made the entire adjustment fell in the second year of the regulatory period.<sup>107</sup>

370. Under this approach there was a risk of fluctuations in allowable revenue (and therefore prices to consumers) resulting from these second-year adjustments.

371. We have decided that we can remedy this issue by relying on the existing ‘capex incentive adjustment’ calculation formula to spread the IRIS adjustment across the remainder of the regulatory period.

372. In submissions on our draft decision, ENA supported our change.<sup>108</sup>

<sup>107</sup> Vector raised a concern about this in: Vector “Commission Proposal to Implement Further Amendments to Input Methodologies (IM) for Electricity Distributors Subject to Price Quality Regulation” (20 March 2015), para 18.

<sup>108</sup> ENA “Input Methodologies review – Report on the IM review” (4 August 2016), para 23.

## Pre-review IRIS IM decision IR05

<b>Decision IR05</b> <b>Treatment of IRIS</b> <b>balances –</b> <b>Transpower</b>  <b>(original 2010</b> <b>decision amended)</b>	<p><b>Original 2010 decision</b></p> <p>While both incremental gains and losses will be carried forward to the subsequent 5 years, only positive net balances of such gains and losses in years in the next regulatory period will be treated as recoverable costs (ie, only net rewards will be recognised).</p> <p>See section 7.5 of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>We put in place an incentive to control expenditure that is the same in each year of the regulatory period. Unlike the pre-existing asymmetric IRIS for opex, the revised IRIS provides incentives that are the same in each year.</p> <p>For opex, the retention period for savings and losses is 5 years following the year of the gain and loss, which is equivalent to a retention factor of around 35% for a supplier.</p> <p>In the second full year after the price-quality path starts to apply to the supplier, a one-off adjustment is made after the carry forward amounts are added together.</p> <p>The one-off adjustment in the second year is required to correct for the difference between the actual and assumed level of opex in the final year of the preceding price-quality path. This adjustment is required because the incremental change in the final year of a price-quality path is assumed to be nil.</p> <p><a href="#">Amendments to input methodologies for electricity distribution services and Transpower New Zealand: Incremental Rolling Incentive Scheme (27 November 2014)</a></p>
<b>This original decision</b> <b>applies to (sector):</b>	Transpower

### *We have made an implementation change for this decision*

373. We have changed IM decision IR05 to amend the Transpower IM ‘opex incentive amount’ calculation to fit the purpose of the ‘adjustment to the opex incentive’ by using a modified version of the ‘capex incentive adjustment’ calculation.<sup>109</sup> This is consistent with the change to IM decision IR02 for EDBs.

<sup>109</sup> We note that there is a specific topic paper being released in Q1 of 2017 in which a draft decision will be made on the Transpower IRIS. Decision IR05 may be revisited, if required, under that process.

*Why we have made this change*

374. We have changed this approach for the same reasons outlined under IM decision IR02.

**Pre-review IRIS IM decision IR08**

<b>Decision IR08</b> <b>IRIS to apply under a CPP – GDBs and GTBs</b>	<b>Original 2010 decision</b> <p>The Commission will implement an IRIS under a CPP. The efficiency gain or loss for a particular year will be calculated as the difference between actual and forecast controllable opex for the current year, minus the difference in the preceding year, the result of which provides the incremental gain/loss for that year.</p> <p>See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	GDB/GTB

*How we have changed this decision*

375. We have changed IM decision IR08 to remove the pre-review asymmetric opex IRIS applying to CPPs for gas pipeline services.

*Why we have made this change*

376. Our emerging views on the IRIS for the GDB and GTB DPPs and CPPs, as outlined in our gas process and issues paper, were (in summary):<sup>110</sup>

376.1 the benefits from implementing a capex and opex IRIS for gas pipeline services would be unlikely to outweigh the costs at this time; and

376.2 if IRIS is not implemented for gas pipeline services in the 2017 Gas DPP resets, the current asymmetric opex IRIS applying to CPPs should be removed for gas pipeline services.

<sup>110</sup> Commerce Commission "Default price-quality paths for gas pipeline services from 1 October 2017 – Process and issues paper" (29 February 2016), para 5.1-5.15.

377. Submissions in relation to IRIS and the Gas DPP resets were received on 24 March 2016 from GasNet Limited, Methanex New Zealand Limited, First State Investments, Maui Development Limited, and Powerco.<sup>111</sup>
378. Overall, submissions commenting on IRIS issues generally supported our emerging views. Powerco and MDL specifically supported our emerging view regarding the existing asymmetric opex IRIS applying in respect of CPPs, and agreed that it should be removed altogether.
379. This change also applies to IM decisions IR09 and IR10.

#### Pre-review IRIS IM decision IR09

<b>Decision IR09</b> <b>Treatment of IRIS balances – GDBs and GTBs</b>	<b>Original 2010 decision</b> <p>While both incremental gains and losses will be carried forward to the subsequent 5 years, only positive net balances of such gains and losses in years in the next regulatory period will be treated as recoverable costs (ie, only net rewards will be recognised).</p> <p>See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	GDB/GTB

#### *How we have changed this decision*

380. We have changed IM decision IR09 to remove the pre-review asymmetric opex IRIS applying to CPPs for gas pipeline services.<sup>112</sup>

#### *Why we have made this change*

381. Our reasons for making this change are the same as the reasons set out under IM decision IR08.

<sup>111</sup> GasNet "Submission on DPP from 2017 for gas pipeline services, process and issues paper – Public version" (24 March 2016), p. 5; Methanex "Gas default price-quality path reset 2017 and other matters" (24 March 2016), p. 2; First State Investments "Gas default price-quality path: Matters related to the input methodologies" (24 March 2016), p. 1-2; MDL, Untitled comments on Gas DPP process and issues paper (24 March 2016), p. 2; and Powerco "Submission on the four emerging view papers (29 February 2016)" (24 March 2016), p. 3 and p. 10.

<sup>112</sup> Commerce Commission "Default price-quality paths for gas pipeline services from 1 October 2017 – Process and issues paper" (29 February 2016), para 5.14-5.15.

**Pre-review IRIS IM decision IR10**

<b>Decision IR10</b> <b>Five-year retention of efficiency gains</b>	<b>Original 2010 decision</b> The length of time suppliers are allowed to retain the efficiency gain is 5 years.  See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

*How we have changed this decision*

382. We have changed IM decision IR10 to remove the pre-review asymmetric opex IRIS applying to CPPs for gas pipeline services.<sup>113</sup>

*Why we have made this change*

383. Our reasons for making this change are the same as the reasons set out under IM decision IR08.

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<sup>113</sup> Commerce Commission "Default price-quality paths for gas pipeline services from 1 October 2017 – Process and issues paper" (29 February 2016), para 5.14-5.15.

## **Part 2: IM decisions that we have not changed**

### **Chapter 10: Introduction to Part 2**

384. This Part lists those pre-review IM decisions that:
- 384.1 in light of our framework, submissions on the IM review, and all other relevant information before us, we considered changing; but
  - 384.2 for the reasons presented in this Part, we decided not to change (either at a policy level, or in terms of the implementation of the decision).
385. For each pre-review IM decision, Part 2 of the report:
- 385.1 states the pre-review IM decision; and
  - 385.2 explains why we have decided not to change it as part of the IM review.
386. Like Part 1, Part 2 is structured according to the grouping of pre-review IM decisions described in the introduction to this report.

## Chapter 11: Cost allocation decisions we have not changed

### Pre-review cost allocation IM decision CA05

<b>Decision CA05</b> <b>Definition of causal relationships</b>	<b>Original 2010 decision</b> 'Causal relationships' are defined in relation to: <ul style="list-style-type: none"> <li>• asset values, as a circumstance in which a factor influences the utilisation of an asset during the 18 month period terminating on the last day of the disclosure year in respect of which the allocation is carried out; and</li> <li>• operating costs, as a circumstance in which a cost driver leads to an operating cost being incurred during the 18 month period terminating on the last day of the disclosure year in respect of which the allocation is carried out.</li> </ul> <p>See Appendix B, section B4 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p>Airports – see Appendix B of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB/Airports

#### *Why we have not changed this decision*

387. Our decision in respect of IM decision CA05 is to make no change.
388. Horizon submitted in 2013 that we should provide clarity about the time period over which a causal relationship (for cost allocation) has to be established when a regulated supplier has acquired a business in the last 18 months.<sup>114</sup> The time period for a causal relationship is relevant for determining which causal (or proxy) allocators a business can apply.
389. The intent of the IM is that a causal relationship can be established over any part of the 18-month period. We have not amended the IM determinations, as the allocator is working as intended.

<sup>114</sup> Commerce Commission “Issues register for electricity and gas information disclosure” (30 March 2016). See row 79 regarding the clarification sought by Horizon on 28 June 2013.

### Pre-review cost allocation IM decision CA11

<b>Decision CA11</b> <b>Allocating not directly attributable cost – Airports</b>	<b>Original 2010 decision</b> Airports must apply ABAA to allocate costs that are ‘not directly attributable’ between each of the three regulated activities, and between regulated and unregulated activities they undertake.  See section 3.3 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

#### *Why we have not changed this decision*

390. Our decision in respect of IM decision CA11 is to make no change.
391. The Board of Airline Representatives New Zealand (BARNZ) originally submitted that the cost allocation IM relating to assets that are not directly attributable is too broad.<sup>115</sup> However, BARNZ subsequently withdrew this submission.<sup>116</sup> There is no other evidence of an issue in this area, and we have therefore not made any changes to IM decision CA11.

<sup>115</sup> BARNZ “Submission by BARNZ on problem definition paper for the input methodologies review” (21 August 2015), p. 1-2.

<sup>116</sup> Letter from Kristina Cooper (Legal and Regulatory Manager, BARNZ) to Hazel Burns (Senior Analyst, Commerce Commission) confirming that BARNZ withdraws its submission on the asset allocator issue, made as part of its submission on the Commission’s Problem definition paper (14 June 2016), available on our website at: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/>.

## Chapter 12: Asset valuation decisions we have not changed

### Pre-review asset valuation IM decision AV03

<b>Decision AV03</b> <b>RAB roll forward with indexation</b>	<b>Original 2010 decision</b> EDBs and GPBs must roll forward the RAB values of their assets using CPI-indexation. For this purpose EDBs and GPBs must use the 'All Groups Index SE9A' published by Statistics New Zealand.  See section 4.3, Appendix E, section E12 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *Why we have not changed this decision*

392. Our decision in respect of IM decision AV03 is to make no change.
393. We discuss issues relating to suppliers' exposure to inflation risk and the time profile of capital recovery in Topic paper 1: Form of control and RAB indexation.
394. Our reasons for deciding not to change this IM decision AV03 in response to those issues are discussed in that topic paper.

## Pre-review asset valuation IM decision AV04

<b>Decision AV04</b> <b>RAB exclusions</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs should exclude from their RAB values:</p> <ul style="list-style-type: none"> <li>• as applicable, any assets not used to provide electricity lines services (as defined by s 54C) and any assets not used to provide gas pipeline services (as defined by s 55A);</li> <li>• any asset that is part of a works under construction;</li> <li>• working capital;</li> <li>• goodwill; and</li> <li>• easement land, that is land acquired for the purpose of creating an easement and with the intention of subsequently disposing of the land.</li> </ul> <p>See section 4.3, Appendix E, sections E2, E3, E5, E6 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

### *Why we have not changed this decision*

395. Our decision in respect of IM decision AV04 is to make no change.
396. We considered Electricity Retailers' Association of New Zealand's (**ERANZ**) submissions for effectively excluding certain assets from the RAB (eg, batteries beyond the meter, even if used to supply regulated services).<sup>117</sup>
397. Our reasons for not changing this decision, including our response to ERANZ's submission, are discussed in Topic paper 3: The future impact of emerging technologies in the energy sector.

<sup>117</sup> Electricity Retailers' Association of New Zealand (ERANZ), "Submission of Emerging Technologies – Workshop and Pre-workshop paper" (4 February 2016), p. 18-20; and ERANZ "Submission to the Commerce Commission on input methodologies for emerging technology" (4 August 2016), p. 14.

## Pre-review asset valuation IM decision AV06

<b>Decision AV06</b> <b>Commissioned assets added to RAB</b>	<b>Original 2010 decision</b> EDBs and GPBs should include capital additions in their RAB values at cost in the year in which the asset is ‘commissioned’, that is when the asset is first used by the regulated supplier to provide electricity distribution services/gas pipeline services. When a regulated supplier disposes of an asset the closing RAB value of that asset, for the disclosure year in which the disposal occurs, is nil.  See section E4, Appendix E of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

### *Why we have not changed this decision*

398. In submissions on our draft decision, Powerco suggested that we should change the time when an asset enters the RAB from the ‘commissioned date’ to the ‘creation date’ in order to allow the RAB to include assets that have been installed, but not yet commissioned. Powerco noted that GAAP does not allow capitalisation once an asset has been installed.<sup>118</sup>
399. We have concluded that there is no material reason to deviate from GAAP under Clause 2.2.11(1) of the EDB, GDB and GTB IM determinations and, in particular, the GAAP references in NZ IAS 16 – the ‘cessation’ rule and NZ IAS 23 – the ‘suspension’ rule, in relation to works under construction.<sup>119</sup>

<sup>118</sup> Powerco “Submission on Input Methodologies Review Draft Decisions” (4 August 2016), p. 65.

<sup>119</sup> External Reporting Board “New Zealand Equivalent to International Accounting Standard 16” (November 2004), para 20(a) and External Reporting Board “New Zealand Equivalent to International Accounting Standard 23” (July 2007), para 20.

### Pre-review asset valuation IM decision AV08

<b>Decision AV08</b> <b>Easement rights</b>	<b>Original 2010 decision</b> EDBs and GPBs must include new easement rights in the RAB value at cost in the year in which the rights are acquired, provided that the RAB value of new easement rights does not exceed fair market value, as determined by an independent valuer.  See section E6, Appendix E of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *Why we have not changed this decision*

400. In its submission on our draft decision, Powerco suggested that it would be useful if the IMs were updated to reflect the rationale in the 2010 IM reasons paper regarding easement rights in the RAB.<sup>120</sup>
401. We consider that no change is necessary as Clause 2.2.11(1)(b) of the EDB, GDB and GTB IM determinations is consistent with paragraph E6.1 of the 2010 EDB-GPB IM reasons paper.<sup>121</sup>

### Pre-review asset valuation IM decision AV18

<b>Decision AV18</b> <b>Assets retained in RAB for ID</b>	<b>Original 2010 decision</b> Where demand for the asset falls away, regulated suppliers may retain the asset in the RAB value for the purpose of ID, and continue to depreciate the asset over its remaining asset life.  See section 11 Appendix E of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *Why we have not changed this decision*

402. Our decision in respect of IM decision AV18 is to make no change.

<sup>120</sup> Powerco "Submission on Input Methodologies Review Draft Decisions" (4 August 2016), p. 65-66.

<sup>121</sup> Commerce Commission "Input methodologies (electricity distribution and gas pipeline services): Reasons paper" (22 December 2010), para E6.1.

403. The issue of asset stranding is discussed in Topic paper 3: The future impact of emerging technologies in the energy sector. Although we have not amended IM decision AV18, we have made an amendment to IM decision AV17 to allow EDBs the option to adjust asset lives by a moderate amount in certain circumstances.
404. Details of the change to IM decision AV17 are set out in Part 1 of this report.

#### Pre-review asset valuation IM decision AV26

<b>Decision AV26</b> <b>No indexation of RAB</b> <b>– Transpower</b>	<b>Original 2010 decision</b> No indexation is to be applied in rolling forward Transpower's RAB value.  See section 4.3, paragraphs 4.4.68-4.4.80 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

#### *Why we have not changed this decision*

405. Our decision in respect of IM decision AV26 is to make no change.
406. We discuss issues relating to Transpower's exposure to inflation risk and the time profile of capital recovery in Topic paper 1: Form of control and RAB indexation. Our reasons for not changing this decision in response to these issues are discussed in that topic paper.

## Pre-review asset valuation IM decision AV27

<p><b>Decision AV27</b></p> <p><b>Commissioned assets added to RAB – Transpower</b></p> <p><b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>Transpower should include capital additions in its RAB value at cost in the year in which the asset is ‘commissioned’, that is when the asset is first ‘used by Transpower to provide electricity transmission services’. In the case of (a) land that is not easement land, and (b) easements, whose acquisition has been approved under Part F of the Electricity Governance Rules (or under the capex IM once it comes into effect), ‘commissioned’ means ‘first acquired by Transpower’.</p> <p>See section 4.3, paragraphs 4.4.68-4.4.80 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>The amendment affects the IMs relating to ID regulation and individual price-quality regulation for Transpower. It will apply to land assets acquired from 1 July 2015, which corresponds to the commencement date of the first disclosure year for RCP2.</p> <p>We have amended the definition of ‘commissioned’ in the IMs to clarify that land which is base capex may enter Transpower’s RAB when acquired, as opposed to when it is first used to supply electricity lines services.</p> <p>Base capex is capex with a forecast cost of less than \$20 million or which relates to specified types of projects or programmes such as asset replacement or asset refurbishment.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Transpower</p>

### *Why we have not changed this decision*

407. We have not amended the definition for ‘capital expenditure’ for the purpose of AV27.

408. In its submission on our technical consultation, Transpower queried why we have a definition for ‘capital expenditure’ in both the Transpower IM and the Transpower Capex IM.<sup>122</sup> Transpower suggested using one common definition for ‘capital expenditure.’
409. We have not amended the definition for ‘capital expenditure’ in the IM determination as the definitions have a different purpose. The definition of ‘capital expenditure’ in the Capex IM is used for the approval of capex and the setting of capex allowances. The definition in the IM determination is used in the value of the RAB. In the Capex IM, ‘non-transmission solutions’ are included within the definition, but may not be capitalised in the RAB for GAAP. Rather than create variations on the same definition, we consider it more appropriate to retain the existing two definitions.

### Pre-review asset valuation IM decision AV29

<b>Decision AV29</b> <b>Asset disposals – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Where Transpower disposes of an asset, the closing RAB value of that asset, for the disclosure year in which the disposal occurs, is nil.</p> <p>See section 4.3, paragraphs 4.4.68-4.4.80 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

#### *Why we have not changed this decision*

410. Our decision in respect of IM decision AV29 is to make no change.
411. We considered whether IM decision AV29 should be changed to accommodate write-offs and dismantling costs for Transpower assets which have been fully depreciated.
412. However, as described below, the price path already takes account of an asset’s end of life costs such as dismantling and write-offs:

<sup>122</sup> Transpower “[REVISED DRAFT] Transpower Input Methodologies Amendments Determination 2016” (3 November 2016)”, p. 7.

- 412.1 Under GAAP, the gain or loss arising from the removal of an item of property, plant and equipment from the balance sheet (ie, 'derecognition') is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item. The gain or loss is included in profit or loss when the item is derecognised.<sup>123</sup>
- 412.2 'Net disposal proceeds' under GAAP is interpreted to include the costs associated with disposing of an asset (eg, dismantling and write-offs) and use of the word 'net' confirms this could be negative.
- 412.3 The loss arising due to dismantling costs and write-offs when removing an asset from the balance sheet would meet the definition of "disposal proceeds" for the purpose of Transpower IPP, and therefore will be recoverable by Transpower under the price-quality path.

### Pre-review asset valuation IM decision AV43

<b>Decision AV43</b> <b>Financing costs on works under construction – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports must capitalise financing costs on works under construction consistent with GAAP, at a rate no greater than the Airport's estimate of its post-tax cost of capital. Airports must cease capitalising financing costs when the asset is commissioned.</p> <p>When works under construction are commissioned, airports must reduce the cost of the asset, established consistent with GAAP, by the amount of any revenue derived in relation to the assets while they were works under construction (where such a reduction is not already made under GAAP, and where the revenue has not already been reported as income under ID).</p> <p>See section 4.3, Appendix C, section C4 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

#### *Why we have not changed this decision*

413. Our decision in respect of IM decision AV43 is to make no change.

<sup>123</sup> See: New Zealand Equivalent to International Accounting Standard 16 (NZ IAS 16), para 67-72.

414. We considered amending IM decision AV43 for consistency between the Airport IMs and the IMs that apply to the other sectors, particularly exempt EDBs. However, we note that the interest during construction cap never applied to airports, and there would not be the same benefit of maintaining consistent disclosures as between exempt EDBs and non-exempt EDBs (IM decision AV14). Therefore, we have not changed this decision.<sup>124</sup>
415. BARNZ submitted that the holding costs of assets held for future use (ie, in respect of 'excluded assets') should be calculated by applying the airport's average cost of borrowings, as per the proposal to use GAAP requirements for works under construction, rather than by each applying its post-tax WACC.<sup>125</sup>
416. We consider that the post-tax WACC remains appropriate for holding costs and for the cost of financing of works under construction for the reasons outlined in our 2010 Airports IM Reasons Paper.<sup>126</sup>

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<sup>124</sup> Note: In our Airports IM June Draft IM Determination we accidentally carried across the change that we made in the EDB June Draft IM Determination to the weighted average cost of borrowings for airports' works under construction. This was an error (as it was at odds with our draft decision on AV43), and was corrected in our Revised Draft Airports IM Determination in October 2016.

<sup>125</sup> BARNZ "[DRAFT] Commerce Act (Specified Airport Services Input Methodologies) Determination 2010) (18 August 2016), p. 28.

<sup>126</sup> Commerce Commission "Input Methodologies (Airport Services) Reasons Paper" (22 December 2010), para C4.13-C4.14.

## Chapter 13: Treatment of taxation decisions we have not changed

### Pre-review treatment of taxation IM decision TX14

<b>Decision TX14</b> <b>Regulatory tax asset value of asset acquired – Transpower</b>	<b>Original 2010 decision</b> <p>The regulatory tax asset value of assets acquired from a supplier of another type of regulated service should remain unchanged in the event of an acquisition of assets used to supply services under Part 4.</p> <p>See paragraphs 5.4.13- 5.4.17 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

#### *Why we have not changed this decision*

417. For the same reasons as specified in IM decision TX01, we have made no change in respect of the treatment of taxation for Transpower following the transfer of assets. Transpower supported our decision to make no change.<sup>127</sup>

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<sup>127</sup> Transpower “IM review: Submission on suite of draft decision papers” (4 August 2016), p. 17.

## Chapter 14: Cost of capital decisions we have not changed

### Pre-review cost of capital IM decision CC01

<b>Decision CC01</b> Cost of capital defined as estimate of WACC	<b>Original 2010 decision</b> The cost of capital is an estimate of firms' WACC which reflects the cost of debt and the cost of equity used to fund investment. A different WACC will apply in respect of the supply of regulated services by EDBs and GPBs.  See sections 6.1, H1, H2 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

#### *Why we have not changed this decision*

418. Our decision is not to change IM decision CC01 or the way it is implemented. Our response to this issue is explained under IM decision CC03 in Part 1 of this report.

### Pre-review cost of capital IM decision CC02

<b>Decision CC02</b> WACC percentile  (original 2010 decision amended)	<b>Original 2010 decision</b> To incentivise efficient investment in regulated services (given the possibility of errors in estimating the WACC) the WACC to apply for DPP and CPPs is specified as the 75 <sup>th</sup> percentile estimate of the WACC.  See section 6.7, H11 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>  <b>2014 amendment to this decision</b> This amendment gives effect to the Commission's decision to move from using the 75 <sup>th</sup> percentile estimate of WACC to the 67 <sup>th</sup> percentile estimate of WACC for the purposes of price-quality regulation for electricity lines services and gas pipeline services.  Our decision was that the specified WACC for EDBs, Transpower and GPBs should be amended, in light of evidence gathered since the IMs were first determined in December 2010. Our decision was that the 67 <sup>th</sup> percentile of our estimated WACC distribution should be used for price-quality path regulation (the 75 <sup>th</sup> percentile is currently used). Our decision has been given effect by amending the cost of capital IMs applying to those businesses.  This decision does not amend the WACC percentile range used for ID regulation. This amendment to the WACC percentile will apply to EDBs on a DPP and to Transpower's IPP when the resets of those price-quality paths
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	take effect in 2015:  <a href="#">Amendment to the WACC percentile for price-quality regulation for electricity lines services and gas pipeline services: Reasons paper (30 October 2014)</a>
<b>This original decision applies to (sectors):</b>	EDB/GDB/GTB

*Why we have not changed this decision*

419. Our decision is not to change IM decision CC02 or the way it is implemented. Our reasons for not changing this decision are discussed in Topic paper 4: Cost of capital issues.

**Pre-review cost of capital IM decision CC08**

<b>Decision CC08</b> <b>Corporate tax rate in WACC estimates</b>	<b>Original 2010 decision</b>  The corporate tax rate is 30% up until the end of the 2011 tax year, and 28% thereafter. Changes in the corporate tax rate will flow through to future post-tax WACC estimates automatically.  See section 6.5, H10 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*Why we have not changed this decision*

420. Our decision is not to change IM decision CC08 or the way it is implemented. Our reasons for not changing this decision are discussed in Topic paper 4: Cost of capital issues.

**Pre-review cost of capital IM decision CC09**

<b>Decision CC09</b> <b>Commercially realistic estimates of WACC</b>	<b>Original 2010 decision</b>  We have compared the estimated WACCs under the IM against a range of other financial and economic information in order to check that the application of the cost of capital IM produces commercially realistic estimates of WACC for EDBs and GPBs.  See section 6.8, H13 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

*Why we have not changed this decision*

421. Our decision is not to change IM decision CC09. We have continued to conduct reasonableness checks, which are discussed in Topic paper 4: Cost of capital issues.

**Pre-review cost of capital IM decision CC11**

<b>Decision CC11</b> <b>Cost of capital defined as estimate of WACC – Transpower</b>	<b>Original 2010 decision</b> <p>The cost of capital is an estimate of the WACC which reflects the cost of debt and the cost of equity used to fund investment. The WACC will apply in respect of the supply of regulated services by Transpower.</p> <p>The Commission has compared the estimated WACC outputs against a range of other financial and economic information in order to check that commercially realistic estimates of WACC for EDBs and Transpower will be produced by the IM. See section 6.1, 6.8, H1, H2, H13 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><a href="#">Input Methodologies (Transpower) Supplementary Reasons Paper for Leverage in Cost of Capital (29 June 2012)</a></p>
<b>This decision applies to (sector):</b>	Transpower

*Why we have not changed this decision*

422. Our decision is not to change IM decision CC11. The WACC is used in a number of different ways in the determination and we consider that the IMs are currently workable and implement the policy adequately. We do not think any further changes are necessary at this time. We will revisit this matter, if necessary, at the next ID determination update.
423. In its submission on our technical consultation, Transpower suggested that references to post-tax WACC should be rationalised and it provided suggested drafting to support its proposal. The proposed drafting did not involve a general policy change related to WACC. However, the WACC is used in a number of different ways in the determination and we considered that undertaking a complete review on this matter may result in unexpected consequential issues that would need to be reviewed for. Because it is only a drafting refinement, that is not intended to result in a change to a policy decision, we considered that this could be practically carried out after the completion of the review.

### Pre-review cost of capital IM decision CC12

<p><b>Decision CC12</b>  <b>WACC percentile – Transpower</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>To incentivise investment in regulated services (given the possibility of error in estimating the WACC) the 75<sup>th</sup> percentile estimate of the vanilla WACC will be applied under the IPP.</p> <p>See section 6.7, H11 of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>This amendment gives effect to the Commission's decision to move from using the 75<sup>th</sup> percentile estimate of WACC to the 67<sup>th</sup> percentile estimate of WACC for the purposes of price-quality regulation for electricity lines services and gas pipeline services. This decision does not amend the WACC percentile range used for ID regulation.</p> <p>Our decision is that the specified WACC for EDBs, Transpower and GPBs should be amended, in light of evidence we have gathered since the IMs were first determined in December 2010. Our decision is that the 67<sup>th</sup> percentile of our estimated WACC distribution should be used for price-quality path regulation (the 75<sup>th</sup> percentile is currently used). Our decision has been given effect by amending the cost of capital IMs applying to those businesses.</p> <p>This amendment to the WACC percentile will apply to EDBs on a DPP and to Transpower's IPP when the resets of those price-quality paths take effect in 2015.</p> <p><a href="#">Amendment to the WACC percentile for price-quality regulation for electricity lines services and gas pipeline services: Reasons paper (30 October 2014)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Transpower</p>

#### *Why we have not changed this decision*

424. Our decision is not to change IM decision CC12 or the way it is implemented. Our reasons for not changing this decision are discussed in Topic paper 4: Cost of capital issues.

### Pre-review cost of capital IM decision CC18

<p><b>Decision CC18</b>  <b>Corporate tax rate in WACC estimates – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>The corporate tax rate is 30% up until the end of the 2011 tax year, and 28% thereafter. Changes in the corporate tax rate will flow through to future post-tax WACC estimates automatically.</p> <p>See section 6.5, H10 of 2010 Transpower IM reasons paper:</p>
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	<a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

*Why we have not changed this decision*

425. Our decision is not to change IM decision CC18 or the way it is implemented. Our reasons for not changing this decision are discussed in Topic paper 4: Cost of capital issues.

**Pre-review cost of capital IM decision CC25**

<b>Decision CC25</b> <b>Corporate tax rate in WACC estimate – Airports</b>	<b>Original 2010 decision</b> The corporate tax rate is 30% up until the end of the 2011 tax year, and 28% thereafter. Changes in the corporate tax rate will flow through to future post-tax WACC estimates automatically.  See sections 6.5, E10 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

*Why we have not changed this decision*

426. Our decision is not to change IM decision CC25 or the way it is implemented. Our reasons for not changing this decision are discussed in Topic paper 4: Cost of capital issues.

**Pre-review cost of capital IM decision CC26**

<b>Decision CC26</b> <b>Commercially realistic estimates of WACC – Airports</b>	<b>Original 2010 decision</b> The Commission has compared the expected WACC outputs under the IM against a range of other financial and economic information in order to check that the application of the cost of capital IM produces commercially realistic estimates of WACC for airports.  See sections 6.8, E13 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

*Why we have not changed this decision*

427. Our decision is not to change IM decision CC26 or the way it is implemented. Our reasons for not changing this decision are discussed in Topic paper 4: Cost of capital issues.

## Chapter 15: Gas pricing methodologies decisions we have not changed

428. Our decisions in respect of GP01, GP02, GP03, GP04 and GP05 are discussed together below.

### Pre-review gas pricing methodologies IM decision GP01

<b>Decision GP01</b> <b>Principles-based approach to gas pricing</b>	<b>Original 2010 decision</b> A ‘principles-based’ approach applies.  See section 7.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

### Pre-review gas pricing methodologies IM decision GP02

<b>Decision GP02</b> <b>Pricing principles to be consistent with Gas Authorisation</b>	<b>Original 2010 decision</b> The pricing principles are consistent with those adopted for the Gas Authorisation, with some minor modifications.  See section 7.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

### Pre-review gas pricing methodologies IM decision GP03

<b>Decision GP03</b> <b>Pricing principles in the IM are to be used to measure consistency under ID</b>	<b>Original 2010 decision</b> Under ID, where a GPB must disclose the extent of consistency of the pricing methodology it actually applies with the pricing principles, or the reasons for any inconsistency between its pricing methodology with the pricing principles, the relevant pricing principles are those set out in the pricing methodologies IM.  See section 7.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

### Pre-review gas pricing methodologies IM decision GP04

<b>Decision GP04</b> <b>No application of gas pricing IM to gas DPPs</b>	<b>Original 2010 decision</b> The IM does not apply to DPPs.  See section 7.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

### Pre-review gas pricing methodologies IM decision GP05

<b>Decision GP05</b> <b>Gas pricing IM may apply to a CPP</b>	<b>Original 2010 decision</b> The IM applies to CPPs, but only to a particular CPP applicant if (at the time of the supplier making its CPP application) the Commission's most recent summary and analysis (under ID) has identified that the IM will apply to that supplier.  See section 7.3, Appendix I of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	GDB/GTB

#### *Why we have not changed these decisions*

429. Our decision in respect of IM decisions GP01, GP02, GP03, GP04 and GP05 is to make no change.
430. Both suppliers and consumers have raised concerns over the usefulness and application of the pricing principles to GTBs.<sup>128</sup> We therefore considered whether these decisions should be changed to:
- 430.1 remove the disclosure requirements which assess a GTB's performance against pricing principles; and
- 430.2 remove the ability to set pricing methodologies in a CPP determination.

<sup>128</sup> MDL, Untitled submission on the gas pipeline stakeholder meeting (28 January 2016), p. 3; MDL, Untitled submission on the problem definition paper (21 August 2015), p. 13; MGUG "IM review – Gas stakeholder meeting 8 December 2015" (28 January 2016), p. 3; Colonial, Untitled submission on the gas pipeline stakeholder meeting (29 January 2016), p. 4.

431. Having reviewed the IMs in light of the submissions, we have not made those changes because:
- 431.1 we consider that issues of pricing are being addressed by the changes we have made to the form of control and by the Gas Industry Company (**GIC**) code convergence programme;
  - 431.2 we will be working with the GIC and stakeholders to assess the impacts of these changes and any new pricing mechanisms that suppliers introduce;
  - 431.3 there is benefit to stakeholders in maintaining the interim ability to assess performance of a GTB against the pricing principles while the codes are aligned and new pricing mechanisms are implemented; and
  - 431.4 having the current disclosure requirements in place also provides stakeholders with a point of reference to raise their issues and allows us, and the GIC, to address those matters as they arise.

## Chapter 16: Specification of price decisions we have not changed

### Pre-review specification of price IM decision SP08

<b>Decision SP08</b> <b>Price specified by revenue cap – Transpower</b>	<b>Original 2010 decision</b> Price for Transpower will be specified by a total revenue cap.  See section 7.3 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

#### *Why we have not changed this decision*

432. Our decision is not to change IM decision SP08 or the way it is implemented. Our reasons for not changing it are set out in Topic paper 1: Form of control and RAB indexation.

#### Automating the Transpower MAR update process

433. In reaching this decision, we also considered an implementation issue raised by Transpower regarding whether there are benefits in amending the IMs to allow us to automate the Transpower MAR update process. We committed to considering this when we made our most recent determination of Transpower’s price-quality path in 2014.<sup>129</sup>
434. We have not amended the Transpower IM Determination to automate the MAR update process at this time, as automating this process would remove our ability to scrutinise the underlying data used. We consider that determining the forecast MAR has proven beneficial to consumers in the past.
435. We may revisit this in future if we become more comfortable with Transpower’s forecast MAR updates. If we do this, we would also need to consider the development of additional features into the IMs or in the compliance requirements of the IPP to enable us to reconsider the price-quality path if we later picked up information that suggested we should do so.

### Pre-review specification of price IM decision SP10

<b>Decision SP10</b> <b>Recoverable costs – Transpower</b>  <b>(original 2010)</b>	<b>Original 2010 decision</b> Recoverable costs include instantaneous reserves availability charges (with some exclusions), the costs of developing and funding transmission alternatives under some conditions, and the net incremental carry forward
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<sup>129</sup> Commerce Commission “Setting Transpower’s individual price-quality path for 2015-2020” (29 August 2014), para 3.29.

**decision amended)**

amount under IRIS.

See section 7.3 of 2010 Transpower IM reasons paper:

[Input Methodologies \(Transpower\) Reasons Paper \(22 December 2010\)](#)

**2014 amendment to this decision (1)**

The amendment affects the IMs relating to the individual price-quality regulation of Transpower. It will apply immediately, with the practical effect of allowing recoverable costs to be calculated in this way from the first disclosure year for RCP2.

We have added a new recoverable cost to the specification of price IM to allow Transpower to recover operating costs that were originally forecast and approved as components of major capex projects.

- The amendment caters for the situation where the expenditure forecast in respect of approved major capex projects is ultimately required to be accounted for under GAAP as opex (such as project feasibility costs).

[Amendments to input methodologies for Transpower 2014: Reasons paper \(28 August 2014\)](#)

**2014 amendment to this decision (2)**

The addition of the new recoverable cost ensures that the overall framework established in respect of catastrophic events is appropriate, whereby Transpower should be:

- compensated through the future amended IPP for prudent additional net costs that are forecast to be incurred after the price-quality path is reset (ie, existing reconsideration provisions);
- cushioned through the future amended IPP against changes in future demand, by factoring in up-to-date forecasts when the price-quality path is reset (ie, existing reconsideration provisions); and
- compensated through an amount in future revenues for prudent additional net costs of the catastrophic event incurred before the price-quality path is amended (ie, new recoverable cost).

The amendment affects the IMs relating to individual price-quality regulation for Transpower.

It will apply immediately, with the practical effect of allowing the recovery of prudent net additional opex following a catastrophic event occurring from the commencement of RCP2.

	<p>The first pricing year in which the amendment may therefore be applied in the setting of Transpower’s transmission revenue under the transmission pricing methodology (<b>TPM</b>) is the pricing year commencing 1 April 2016.</p> <p>We have amended the specification of price IM to allow Transpower to recover, as a recoverable cost, prudent net additional opex incurred in the period between the date of a catastrophic event and the effective date of any resulting amended IPP arising from a reconsideration of the IPP.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<b>This original decision applies to (sector):</b>	Transpower

*Why we have not changed this decision*

436. Our decision is not to change IM decision SP10 or the way it is implemented.
437. In June 2013 Transpower requested a series of IM changes, including a request for the Commission to:<sup>130, 131</sup>
- Amend the definition of “operating expenditure” in the IPP to exclude black start and over-frequency arming. Amend the definition of “pass-through costs” in the Transpower IM to include: ... Black start and over-frequency arming costs.
438. We consider that black start and over-frequency arming costs are currently part of the operating cost allowance set by the Commission for RCP2 (ie, the currently price-quality regulatory period applying to Transpower), and Transpower must therefore manage the risk of forecasting these costs within the overall pool of opex.
439. Based on the information provided, we do not see a reason to consider that black start and over-frequency costs are materially different to any other operating cost faced by Transpower. We therefore consider that the policy intent of the IM decision is being achieved.

<sup>130</sup> Letter from Jeremy Cain (Transpower) to Dane Gunnell (Senior Analyst, Commerce Commission) regarding amendments to Transpower Input Methodologies for RCP2 (14 June 2013), p. 5. Available at: <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/amendments-and-clarifications/>.

<sup>131</sup> In its submission on our draft decision, Transpower stated, “We consider the reasons set out in our 2013 IM amendment request to be valid”, but did not provide any further information or reasoning: Transpower “IM review: Submission on suite of draft decision papers” (4 August 2016), Appendix C.

## Chapter 17: IRIS decisions we have not changed

### Pre-review IRIS IM decision IR01

<p><b>Decision IR01</b>  <b>IRIS to apply – EDBs</b>   <b>(original 2010 decision amended)</b></p>	<p><b>Original 2010 decision</b></p> <p>The Commission will implement an IRIS under a CPP. The efficiency gain or loss for a particular year will be calculated as the difference between actual and forecast controllable opex for the current year, minus the difference in the preceding year, the result of which provides the incremental gain/loss for that year.</p> <p>See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision (1)</b></p> <p>The revised IRIS provides a time consistent incentive to control opex and, for DPPs, capex too.</p> <p>For opex, the retention period for savings and losses is 5 years following the year of the gain and loss, which is equivalent to a retention factor of around 35% for a supplier.</p> <p>We have provided a time consistent incentive for capex that is similar to the incentive on base capex for Transpower New Zealand. The IRIS introduced in 2010 for other suppliers did not apply to capex.</p> <p>Unlike the approach for opex, we specify the retention factor directly for capex, rather than specifying a retention period. In addition, the choice of retention factor will be decided at the time of each price-quality path reset.</p> <p><a href="#">Amendments to input methodologies for electricity distribution services and Transpower New Zealand: Incremental Rolling Incentive Scheme (27 November 2014)</a></p> <p><b>2015 amendment to this decision (2)</b></p> <p>As a CPP may be a response to unforeseen circumstances that have a significant impact on a supplier, we consider that some flexibility on the application of IRIS under different circumstances is required.</p> <p>We have introduced a clause to the determination that allows use of an alternative allowance of opex or capex for the purposes of calculating IRIS adjustments. We envisage this clause would be used in certain circumstances to ensure consistency across a CPP.</p> <p>The ENA noted that, under s 53X(2), we are able to advise the suppliers of different starting prices that apply following the expiry of a CPP. It is possible that these prices may not have an underlying opex forecast from which to calculate IRIS carry over amounts.</p>
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We have addressed this issue through an update to the determination. Under the new clause, at the expiration of the CPP, the Commission will notify the party of the forecast opex and forecast value of commissioned assets to use for the purpose of calculating the IRIS carry over amounts.

To give effect to the IRIS in all situations we have introduced a number of additional adjustment terms to the IMs that apply under different scenarios.

We have identified six generic scenarios that may occur under default/customised price-quality regulation. Under each of these scenarios suppliers will need to apply one or more of the proposed adjustment terms.

Table 5.2 (of the reasons paper) shows which adjustment terms need to be applied in each of the scenarios described above together with references to the clauses that apply in the accompanying determination:

	Scenario					
	1	2	3	4	5	6
Clause reference	3.3.4 (2) (a)	3.3.4 (2) (b)	3.3.4 (3)	3.3.4 (4)	3.3.4 (5)	3.3.4 (6)
Base year adjustment term	✓	✓	✓	✓	✓	
Baseline adjustment term			✓		✓	✓
Roll-over adjustment term		✓		✓		
One-year adjustment term 1				✓	✓	
One-year adjustment term 2				✓	✓	
One-year adjustment term 3				✓	✓	
One-year adjustment term 4						✓

	One-year adjustment term 5						✓
	One-year adjustment term 6						✓
	One-year adjustment term 7						✓
	One-year adjustment term 8						✓
	One-year adjustment term 9						✓
<p>The baseline adjustment term is now defined separately for different scenarios. This gives effect to the revised (Powerco) approach when EDBs are transitioning onto a CPP:</p> <ul style="list-style-type: none"> <li>• Under Scenarios 3 and 5 it is defined under clause 3.3.7 (1) of the IMs; and</li> <li>• Under Scenario 6 it is defined under clause 3.3.7 (2) of the IMs.</li> </ul> <p><a href="#">Further amendments to input methodologies for electricity distributors subject to price-quality regulation - Incremental Rolling Incentive Scheme (IRIS) (25 November 2015)</a></p>							
<b>This original decision applies to (sector):</b>	EDBs						

*Why we have not changed this decision*

440. We have decided not to change IM decision IR01.

441. There are two issues we considered in respect of this IM decision:

441.1 a potential error identified by Dr Martin Lally; and

441.2 an issue with the roll-over adjustment term for single year DPPs.

Potential error identified by Dr Lally

442. In his review of WACC issues, Dr Lally suggested that the IRIS mechanism's treatment of opex includes a 'design error':<sup>132</sup>

In summary, the Commission's approach to opex is consistent with the NPV = 0 principle but inflation forecasting errors arising from opex raise prices by more than the inflation shock because inflation forecasting errors are compensated for twice. This would appear to be a design error.

443. We agree that from a logical standpoint any disparity between the opex allowance and the actual opex that is due to CPI forecasting error should probably not be covered under IRIS, as it is fully compensated through our provision of a real return.

444. However, to implement Dr Lally's suggested approach:

444.1 we would need to identify the relationship between the forecast CPI and the forecast opex input price forecast (eg, confirm whether a 1% error in CPI forecasts also means a 1% error in opex input price forecasts); and

444.2 if there is a relationship, estimate and eliminate the impact of the CPI forecast error from the out-turn of actual opex prior to making IRIS adjustments.

445. The potential benefit of making this fix does not appear to outweigh the additional complexity it would create, given the opex incentive rate is only an estimate in any case (ie, it is currently 34%, based on a five-year retention of permanent savings, but this changes with the WACC).

Issue with the way that IRIS recoverable costs are calculated for single-year DPPs

446. There is a potential issue with the way that IRIS recoverable costs are calculated when a CPP is followed by a DPP that has only one year of the DPP regulatory period remaining.

447. We have chosen not to make a change in response to this issue at this time. Based on our current understanding about the timing of potential CPP applications, we do not expect this issue to cause a problem for the foreseeable future. However, should we be made aware of a supplier that intends to submit a CPP application with an approval date targeted in 2019, then we will consider our options for making a targeted amendment.

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<sup>132</sup> Dr Lally's expert advice on the cost of debt, asset beta adjustments for GPBs, RAB indexation and inflation risk, and TAMRP "Review of further WACC issues" (report to the Commerce Commission, 22 May 2016), p. 40.

448. We also note that Orion will have one year of the DPP regulatory period remaining when its current CPP ends. However, as confirmed in our final report on Orion’s transition to the 2015-2020 DPP, the IMs establish that Orion does not need to calculate an opex or capex incentive amount for any year commencing on or prior to 1 April 2020.<sup>133, 134</sup>

#### Pre-review IRIS IM decision IR04

<b>Decision IR04</b> <b>IRIS to apply under an IPP – Transpower</b>	<b>Original 2010 decision</b> <p>The Commission will implement an IRIS under an IPP. The efficiency gain or loss for a particular year will be calculated as the difference between actual and forecast controllable opex for the current year, minus the difference in the preceding year, the result of which provides the incremental gain/loss for that year.</p> <p>See section 7.5 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

#### *Why we have not changed this decision*

449. We have not yet completed our review of the Transpower IRIS IM and we are not yet in a position to reach a decision on whether to make any changes to it.
450. We acknowledge concerns raised by Transpower about the operation of its IRIS mechanism.<sup>135</sup> We intend doing further analysis to define whether Transpower’s concerns amount to a problem with the current scheme and whether any improvements might involve changes to the IM.
451. We aim to have a final determination on the Transpower IRIS in Q2 2017. Prior to then, we plan to consult in early 2017 on a draft decision on whether to make changes to the IM.

<sup>133</sup> Commerce Commission, “Orion’s transition to the 2015-2020 default price-quality path – Key considerations and possible approaches” (14 March 2016), para 39.

<sup>134</sup> *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26, as amended, clauses 3.3.2(3)(a) and 3.3.10.

<sup>135</sup> Transpower “Incremental rolling incentive scheme” (20 March 2015), available at: <http://www.comcom.govt.nz/dmsdocument/13059>; Transpower “Input methodologies: Scoping the statutory review” (31 March 2015).

**Pre-review IRIS IM decision IR06**

<b>Decision IR06</b> <b>Five-year retention of efficiency gains – Transpower</b>	<b>Original 2010 decision</b> The length of time Transpower is allowed to retain the efficiency gain is 5 years.  See section 7.5 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

*Why we have not changed this decision*

452. We have not yet completed our review of the Transpower IRIS IM and we are not yet in a position to reach a decision on whether to make any changes to IM decision IR06. See IM decision IR04 above.
453. We aim to have a final determination on the Transpower IRIS in Q2 2017. Prior to then, we plan to consult in early 2017 on a draft decision on whether to make changes to the IM.

## **Part 3: IM decisions that we have not changed and found no reason to consider changing**

### **Chapter 18: Introduction to Part 3**

454. This Part of the paper lists the pre-review IM decisions that:

454.1 in light of our framework, submissions on the IM review, and all other relevant information before us, we found no reason to consider changing;<sup>136</sup> and

454.2 we decided not to change at a policy level, or in terms of the implementation of the decision.

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<sup>136</sup> That is not to say there have never been any issues raised in respect of the pre-review IM decisions listed in this Part of the report. Minor issues have been raised in the past that are relevant to some of the pre-review IM decisions listed here; but none that, when we carried out our effectiveness review, we considered were sufficiently material to lead us to consider changing the IMs.

## Chapter 19: Decisions we have not changed, and found no reason to consider changing

### Cost Allocation IM decisions

<b>Decision CA01</b> <b>Allocating directly attributable cost</b>	<b>Original 2010 decision</b> <p>If a cost is solely and wholly caused by a single type of regulated service the cost is 'directly attributable' and is allocated solely to that type of service.</p> <p>See section 3.3 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision CA06</b> <b>Variation to three allocation approaches</b>	<b>Original 2010 decision</b> <p>Suppliers may also clarify their cost allocation policy more directly (than through the use of the three approaches) through their own operational practices. Where this is the case, the IM allows suppliers to make voluntary deductions for operating costs and asset values that have been recovered in arm's-length transactions.</p> <p>See sections 3.3, Appendix B, section B7 of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision CA07</b> <b>No cost allocation for common costs – Transpower</b>	<b>Original 2010 decision</b> <p>Transpower is not required to adjust the total costs associated with supplying electricity transmission services to take into account any costs that might be common to regulated and unregulated services.</p> <p>See section 3.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<p><b>Decision CA08</b>  <b>Operating costs must be adjusted for system operator costs – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>System operator services are defined under Part 4 as electricity line services.</p> <p>Operating costs or asset values allocated to activities undertaken by Transpower to supply electricity transmission services other than system operator services, must be net of costs or asset values implicitly or explicitly recoverable by Transpower in respect of any agreement between it and the Electricity Authority in respect of the system operator services.</p> <p>In addition, fixed assets used solely for the purposes of supplying system operator services are to be excluded from Transpower’s RAB. Any costs recovered through such an agreement are to be excluded from any opex or capex forecasts used to determine Transpower’s IPP.</p> <p>See section 3.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

<p><b>Decision CA09</b>  <b>Costs associated with new investment contracts – Transpower</b></p>	<p><b>Original 2010 decision</b></p> <p>Services provided by New Investment Contracts (<b>NICs</b>) fall under the Part 4 definition of electricity lines services as it involves the conveyance of electricity by line.</p> <p>Fixed assets associated with NICs are to be excluded from Transpower’s RAB. Any capex included in NICs is to be excluded from any capex forecasts used to determine Transpower’s IPP.</p> <p>Transpower should continue to include all operating costs associated with NICs within its total operating costs associated with providing regulated services.</p> <p>See section 3.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sector):</b></p>	<p>Transpower</p>

<b>Decision CA10</b> <b>Allocating directly attributable cost – Airports</b>	<b>Original 2010 decision</b> If a cost is solely and wholly caused by a single activity the cost is ‘directly attributable’ and is allocated solely to that activity.  See section 3.3 of 2010 Airports IM reasons paper:  <a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Airports

### Asset Valuation IM decisions

<b>Decision AV01</b> <b>Initial RAB values for EDBs and GPBs</b>	<b>Original 2010 decision</b> EDBs and GPBs must establish their initial RAB values from existing regulatory valuations, namely: <ul style="list-style-type: none"> <li>• the regulatory asset values disclosed in 2009 in accordance with applicable ID requirements; or</li> <li>• in the case of assets that are subject to the Gas Authorisation, the RAB values determined under the Gas Authorisation as at 30 June 2005, updated to the financial year ending in 2009 for capex, depreciation and CPI-indexation.</li> </ul> See section 4.3 of 2010 EDB-GPB IM reasons paper:  <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<p><b>Decision AV02</b></p> <p><b>Adjustments to initial RAB values</b></p>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs to adjust their initial RAB values to:</p> <ul style="list-style-type: none"> <li>• correct for known errors in asset registers, with respect to the application of valuation approaches under existing ID requirements (with the exception of asset covered by the Gas Authorisation);</li> <li>• make adjustments to ensure that assets included in the initial RAB values align with the definitions of electricity lines services and gas pipeline services provided for in sections 54C and 55A of the Commerce Act;</li> <li>• in the case of EDBs: <ul style="list-style-type: none"> <li>○ adjust the application of multipliers in their 2004 optimised deprival value (<b>ODV</b>) valuations where better information has become available since 2004 (including revised ranges and application for some multipliers);</li> <li>○ reapply the optimisation and EV tests set out in the 2004 ODV Handbook, with respect to assets where an optimisation or EV adjustment in 2004 led to either a full or partial write-down;</li> <li>○ ensure finance during construction (<b>FDC</b>) costs are accounted for in establishing the initial RAB value of assets; and</li> </ul> </li> <li>• in the case of Vector’s NGC Distribution and NGC Transmission assets, adjust the value to provide for CPI indexation from the first day of the disclosure year 2006.</li> </ul> <p>See section 4.3, Appendix E, section E2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

<b>Decision AV07</b> <b>Network spares</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs should include network spares in the roll forward as additions to the RAB value where they are:</p> <ul style="list-style-type: none"> <li>• treated as the cost of an asset under GAAP (wholly or in part); and</li> <li>• held in appropriate quantities, considering the historical reliability of the equipment and the number of items installed on the network.</li> </ul> <p>See section E4, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<b>Decision AV10</b> <b>Vested assets</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs must include vested assets in the RAB value at the cost to the supplier, consistent with GAAP, provided that the RAB value does not exceed the amount of consideration paid by the regulated supplier in respect of the asset.</p> <p>See section E7, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<b>Decision AV11</b> <b>Lost and found assets</b>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs must remove assets recognised as lost from the RAB value in the year in which they are identified as lost, and must reduce the RAB value by the asset's opening RAB value in that year. Once the initial RAB value has been established, lost assets that were in the original RAB will be permitted to remain in the RAB value.</p> <p>Once the initial RAB value has been established found assets are limited to assets commissioned after the 2009 disclosure year.</p> <p>Regulated suppliers must add found assets to the RAB in the year in which they are found, and must establish the RAB value of found assets at cost, consistent with GAAP, where sufficient records exist.</p> <p>Where sufficient records do not exist, regulated suppliers may assign the asset the same value as a similar asset in the RAB (where such an asset exists). If no such similar asset exists, regulated suppliers must use the asset's market value as verified by an independent valuer.</p> <p>See section E9, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

<p><b>Decision AV15</b> Revenues received on works under construction</p>	<p><b>Original 2010 decision</b></p> <p>When they commission works under construction EDBs and GPBs must reduce the cost of asset, established consistent with GAAP, by the amount of any revenue derived in relation to the assets while they were works under construction (where such a reduction is not already made under GAAP, and where the revenue has not already been reported as income under ID).</p> <p>See section E5, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

<p><b>Decision AV16</b> Straight line depreciation applies</p>	<p><b>Original 2010 decision</b></p> <p>EDBs and GPBs must depreciate assets in their RAB using straight line depreciation.</p> <p>Regulated suppliers subject to default/customised price-quality regulation may apply to use an alternative depreciation approach under a CPP.</p> <p>Total (unallocated) depreciation over the lifetime of the asset must not exceed the value at which the asset is first recognised in the RAB under Part 4 (after adjusting for the effects of revaluations).</p> <p>Regulated suppliers may not depreciate land and easements (other than fixed life easements).</p> <p>See section E10, Appendix E of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

<b>Decision AV19</b> <b>Cost allocation applies to unallocated RAB</b>	<p><b>Original 2010 decision</b></p> <p>Regulated suppliers must record the total (ie, 'unallocated') value of an asset in the asset base and roll it forward (for depreciation, revaluations, additions etc.) on an unallocated basis. The cost allocation IM is applied to this asset value whenever it is necessary to determine a specifically attributable (ie, 'allocated') portion of the asset value for regulated activities (for example to calculate depreciation and revaluations).</p> <p>See section E13, Appendix E of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision AV20</b> <b>Initial RAB values – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Transpower must establish initial RAB values for its assets based on the values determined under the settlement agreement as at 30 June 2011.</p> <p>See section 4.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower
<b>Decision AV21</b> <b>Pseudo asset in initial RAB – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>The initial value of RAB should include the remaining value of the HVAC lines pseudo asset, established by the settlement agreement, as at 30 June 2011.</p> <p>See section 4.3, paragraphs 4.4.25- 4.4.30 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision AV22</b> <b>RAB exclusions –</b> <b>Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Transpower should exclude from its RAB value:</p> <ul style="list-style-type: none"> <li>• any assets not used to provide electricity transmission services;</li> <li>• any asset that is part of a works under construction;</li> <li>• working capital;</li> <li>• goodwill; and</li> <li>• easement land, that is land acquired for the purpose of creating an easement, and with the intention of on-selling the land.</li> </ul> <p>See section 4.3, paragraphs 4.4.31-4.4.48, 4.4.60-4.4.63, 4.4.58-4.4.59, 4.4.89-4.4.103 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower
<b>Decision AV23</b> <b>System operator</b> <b>assets excluded from</b> <b>RAB – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Assets associated with delivering an agreement between Transpower and the Electricity Authority in respect of the provision of system operator services are excluded from the RAB value as the result of applying the cost allocation methodology.</p> <p>See section 4.4, paragraphs 4.4.15- 4.4.24 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower
<b>Decision AV24</b> <b>New investment</b> <b>contract assets</b> <b>valued at zero -</b> <b>Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Assets provided under NICs are included in the RAB at zero value.</p> <p>See section 4.4, paragraphs 4.4.4-4.4.14 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision AV25</b> <b>Finance leases and intangible assets – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Transpower may include in its RAB value finance leases and intangible assets, provided that they are identifiable non-monetary assets that are not goodwill, consistent with the meanings under GAAP. Transpower must establish the value of permitted intangible assets added to the RAB value after 30 June 2011 using the cost model for recognition under GAAP. Transpower may not include operating leases in its RAB value.</p> <p>See section 4.4, paragraphs 4.4.49-4.4.57, 4.4.64-4.4.67 of 2010 IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision AV28</b> <b>Network spares – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Where the cost of a network spare is treated as the cost of an asset under GAAP (wholly or in part), it may be added to the RAB value at the date on which it is 'commissioned'.</p> <p>See section 4.3, paragraphs 4.4.68-4.4.80 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision AV30</b> <b>Easements – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Transpower may include easements in its RAB value at cost in the year in which the rights are acquired, provided that:</p> <ul style="list-style-type: none"> <li>• the investments have been approved under the grid investment test in Part F of the Electricity Governance Rules; and</li> <li>• where Transpower acquires land to create a new easement, the cost of the easement is limited to the sum of:             <ul style="list-style-type: none"> <li>○ legal and administrative costs;</li> <li>○ the detrimental impact on the value of the land, as determined by a valuer; and</li> <li>○ the cost of holding the land, calculated as the financing cost on the purchase of the land from the date Transpower acquires the land until the date the easement is created.</li> </ul> </li> </ul> <p>See section 4.4, paragraphs 4.4.89 – 4.4.103 of 2010 Transpower IM reasons paper:</p>
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	<a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision AV31</b> <b>Lost and found assets – Transpower</b>	<b>Original 2010 decision</b> Transpower must remove assets recognised as lost from its RAB value in the disclosure year in which they are identified as lost, and should reduce the RAB value by the opening RAB value of the asset in that year. Once the initial RAB value has been established, lost assets that were in the initial RAB will be permitted to remain in the RAB value.  Found assets are limited to assets commissioned after the 2011 disclosure year. Transpower should add found assets to the RAB value in the year in which they are found, and must establish the RAB value of found assets at cost, consistent with GAAP, where sufficient records exist.  Where sufficient records do not exist, Transpower may assign the asset the same value as a similar asset in the RAB (where such an asset exists). If no such similar asset exists, Transpower must use the asset's market value at the time the found asset is added to the RAB value, as verified by an independent valuer.  See section 4.4, paragraphs 4.4.85- 4.4.88 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
	<b>This decision applies to (sector):</b>

<b>Decision AV34</b> <b>Straight line depreciation applies – Transpower</b>	<b>Original 2010 decision</b> Transpower must depreciate assets in its RAB using straight line depreciation. It may not depreciate land and easements (other than fixed life easements).  See section 4.4, paragraphs 4.4.104 – 4.4.108 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a>
	<b>This decision applies to (sector):</b>

<b>Decision AV36</b> <b>Stranded assets – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>In the case of stranded assets, Transpower may apply accelerated depreciation in the year in which the asset becomes stranded, where the Commission approves this in accordance with the IPP Determination.</p> <p>See section 4.4, paragraphs 4.4.130- 4.4.139 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower
<b>Decision AV37</b> <b>Asset lives when asset is coming to end of life – Transpower</b>  <b>(original 2010 decision amended)</b>	<p><b>Original 2010 decision</b></p> <p>For the purposes of individual price-quality regulation, system fixed assets in service at the start of a period of individual price-quality regulation should be deemed to have a remaining physical asset life equal to the duration of the regulatory period.</p> <p>See section 4.4, paragraphs 4.4.140- 4.4.143 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b></p> <p>The amendment affects the IMs relating to ID regulation and individual price-quality regulation for Transpower. It will apply to depreciation calculated in respect of assets from 1 July 2015, which corresponds to the commencement date of the first disclosure year for RCP2.</p> <p>We have removed the requirement in the asset valuation IM to spread the regulatory depreciation allowance for assets that reach the end of their depreciable life, across the remainder of a regulatory control period.</p> <p><a href="#">Amendments to input methodologies for Transpower 2014: Reasons paper (28 August 2014)</a></p>
<b>This original decision applies to (sector):</b>	Transpower

<b>Decision AV38</b> <b>Cost allocation applies to unallocated RAB – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Transpower must record the total (ie, ‘unallocated’) value of an asset base and roll it forward (for depreciation, revaluations, additions etc) on an unallocated basis. The cost allocation IM is applied to this asset value whenever it is necessary to determine a specifically attributable (ie, ‘allocated’) portion of the asset value for regulated activities (for example to calculated depreciation and revaluations).</p> <p>See section 4.5, Chapter 3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower
<b>Decision AV39</b> <b>Initial RAB values for non-land assets – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports must establish the initial value of their non-land assets using existing regulatory valuations, specifically asset values as on the last day of the disclosure year 2009, and as disclosed in the 2009 disclosure financial statements.</p> <p>See section 4.3 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports
<b>Decision AV44</b> <b>Finance leases and intangible assets – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports may include in their RAB values finance leases and intangible assets provided that they are identifiable non-monetary assets that are not goodwill, consistent with the meanings under GAAP. Airports must establish the value of permitted intangible assets added to RAB value after the last day of the disclosure year 2009 using the cost model for recognition under GAAP.</p> <p>See section 4.3, Appendix C, section C5 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision AV45</b> <b>Commissioned assets added to RAB – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports should include capital additions in their RAB values at cost in the year in which the asset is ‘commissioned’, that is when the asset is first ‘used by the Airport to provide specified airport services other than excluded services’. When an Airport disposes of an asset the closing RAB value of that asset, for the disclosure year in which the disposal occurs, is nil.</p> <p>See section 4.3, Appendix C, section C6 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision AV47</b> <b>Lost and found assets – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports must remove assets recognised as lost from their RAB values in the disclosure year in which they are identified as lost, and must reduce the RAB value by the asset's opening RAB value in that year. From the end of the 2012 disclosure year, lost assets that were in the initial RAB value will be permitted to remain in the RAB value.</p> <p>After the end of the 2012 disclosure year, airports may only add found assets to the RAB value that were commissioned after the 2009 disclosure year. Airports must add found assets to the RAB value in the year in which they are found, and must establish the RAB value of found assets at cost, consistent with GAAP, where sufficient records exist.</p> <p>Where sufficient records do not exist, the Airport may assign the asset the same value as a similar asset in the RAB (where such an asset exists). If no such similar asset exists, the Airport must use the asset’s market value as verified by an independent valuer (in the case of land, the market value must be determined using Schedule A of the IM Determination).</p> <p>See Appendix C, section C8 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision AV49</b> <b>Easement rights – Airports</b>	<p><b>Original 2010 decision</b></p> <p>All airports must include new easement rights in the RAB value at cost in the year in which the rights are acquired, provided that the RAB value of new easement rights does not exceed fair market value, as determined by an independent valuer.</p> <p>See Appendix C, section C10, of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
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<b>This decision applies to (sector):</b>	Airports
<b>Decision AV51</b> <b>Asset lives and limit on unallocated depreciation – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports may determine asset lives for airport assets. However, total (unallocated) depreciation over the lifetime of the asset must not exceed the value at which the asset is first recognised in the Airport's RAB value under Part 4 (after adjusting for the effects of revaluations).</p> <p>See Appendix C, section C11 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports
<b>Decision AV52</b> <b>Stranded assets – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Where an asset is stranded or expected to become stranded, airports may adjust the asset life consistent with the requirements in respect of asset lives.</p> <p>See Appendix C, section C12 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports
<b>Decision AV53</b> <b>Cost allocation applies to unallocated RAB – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Airports must record the total (ie, 'unallocated') value of an asset in the asset base and roll it forward (for depreciation, revaluations, additions etc) on an allocated basis. The cost allocation IM is applied to this asset value whenever it is necessary to determine a specifically attributable (ie, 'allocated') portion of the asset value for regulated activities (for example to calculated depreciation and revaluations).</p> <p>See Appendix C, section C14 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

## Treatment of Taxation IM decisions

<b>Decision TX03</b> <b>Tax losses ignored</b>	<b>Original 2010 decision</b> <p>Tax losses in the wider tax group must be ignored when estimating tax costs.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision TX05</b> <b>Initial regulatory tax asset value</b>	<b>Original 2010 decision</b> <p>The initial regulatory tax asset value in 2009 (as at 31 March) should be the lesser of that recognised under tax rules for the relevant assets or share of assets used to supply electricity or gas distribution services, or the initial RAB value.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision TX06</b> <b>Initial deferred tax balance is zero – EDBs and GDBs</b>	<b>Original 2010 decision</b> <p>The initial deferred tax balance should be zero.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB
<b>Decision TX07</b> <b>Tax effect of discretionary discounts and rebates – EDBs</b>	<b>Original 2010 decision</b> <p>For EDBs only, discretionary discounts and customer rebates should be treated as a tax deductible expense, if allowed under tax legislation, but should not be treated as a cost for the purposes of disclosing or determining regulated revenue.</p> <p>See Appendix G of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>

<b>This decision applies to (sector):</b>	EDBs
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<b>Decision TX09</b> <b>Tax payable approach applies – GTBs</b>	<p><b>Original 2010 decision</b></p> <p>Tax cost must be estimated using a tax payable approach.</p> <p>See section 5.3 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
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<b>This decision applies to (sector):</b>	GTBs
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<b>Decision TX10</b> <b>Tax payable approach applies – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Transpower's tax obligations should be estimated using a tax payable approach.</p> <p>See section 5.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
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<b>This decision applies to (sector):</b>	Transpower
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455. In its submission on our draft decision, Transpower supported our decision to make no change to IM decision TX10.<sup>137</sup>

<b>Decision TX11</b> <b>Tax legislation and cost allocation to be applied – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>The cost allocation IM is to be applied, and tax legislation is to be applied (to the extent practicable and subject to other relevant provisions in the IMs) to calculate the regulatory taxable income.</p> <p>See section 5.3 paragraph 5.4.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
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<b>This decision applies to (sector):</b>	Transpower
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456. In its submission on our draft decision, Transpower supported our decision to make no change to IM decision TX11.<sup>138</sup>

<sup>137</sup> Transpower "IM review: Submission on suite of draft decision papers" (4 August 2016), p. 17.

<sup>138</sup> Transpower "IM review: Submission on suite of draft decision papers" (4 August 2016), p. 17.

<b>Decision TX12</b> <b>Notional leverage for deductible debt interest – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Tax deductible debt interest should be calculated using a notional leverage that is consistent with the cost of capital IM.</p> <p>See paragraphs 5.4.4- 5.4.7 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

457. In its submission on our draft decisions, Transpower supported our decision to make no change to IM decision TX12.<sup>139</sup>

<b>Decision TX13</b> <b>Tax losses ignored – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>Tax losses in Transpower's wider tax group should be ignored when estimating tax costs, and any tax losses generated in the supply of regulated services should be notionally carried forward to the following disclosure year.</p> <p>See paragraphs 5.4.9- 5.4.12 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

458. In its submission on our draft decisions, Transpower supported our decision to make no change to IM decision TX13.<sup>140</sup>

<b>Decision TX15</b> <b>Initial regulatory tax asset value – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>The initial regulatory tax asset value should be the lesser of that recognised by Inland Revenue for the relevant assets or share of assets used by Transpower to supply regulated electricity line services, and the initial RAB value.</p> <p>See paragraphs 5.4.18- 5.4.20 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

459. In its submission on our draft decisions, Transpower supported our decision to make no change to IM decision TX15.<sup>141</sup>

<sup>139</sup> Transpower "IM review: Submission on suite of draft decision papers" (4 August 2016), p. 17.

<sup>140</sup> Transpower "IM review: Submission on suite of draft decision papers" (4 August 2016), p. 17.

<sup>141</sup> Transpower "IM review: Submission on suite of draft decision papers" (4 August 2016), p. 17.

<b>Decision TX17</b> <b>Tax legislation and cost allocation to be applied – Airports</b>	<p><b>Original 2010 decision</b></p> <p>The cost allocation IM is to be applied, and tax legislation is to be applied (to the extent practicable and subject to the other relevant provisions in the IMs), to calculate the regulatory taxable income.</p> <p>See Appendix D, section D2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision TX18</b> <b>Notional leverage for deductible debt interest – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Tax deductible debt interest should be calculated using a notional leverage that is consistent with the cost of capital IM.</p> <p>See Appendix D, section D2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision TX19</b> <b>Tax losses ignored – Airports</b>	<p><b>Original 2010 decision</b></p> <p>Tax losses in an Airport’s wider tax group should be ignored when estimating tax costs, and any tax losses generated in the supply of airport services should be notionally carried forward to the following disclosure year.</p> <p>See Appendix D, section D2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

<b>Decision TX21</b> <b>Initial regulatory tax asset value – Airports</b>	<p><b>Original 2010 decision</b></p> <p>The initial regulatory tax asset value should be the lesser of that recognised by Inland Revenue for the relevant assets or share of assets used to supply airport services, and the initial RAB value.</p> <p>See Appendix D, section D2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports

### Cost of Capital IM decisions

<b>Decision CC04</b> <b>Vanilla WACC and post-tax WACC estimation methodology</b>	<p><b>Original 2010 decision</b></p> <p>The methodology for estimating a vanilla WACC is:</p> $\text{cost of debt} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>The methodology for estimating a post-tax WACC is:</p> $\text{cost of debt (after corporate tax)} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>See sections 6.7, H2 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB
<b>Decision CC14</b> <b>Vanilla WACC and post-tax WACC estimation methodology – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>The methodology for estimating a vanilla WACC is:</p> $\text{cost of debt} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>The methodology for estimating a post-tax WACC is:</p> $\text{cost of debt (after corporate tax)} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>See sections 6.7, H2 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

<b>Decision CC21</b> <b>Vanilla WACC and post-tax WACC estimation methodology – Airports</b>	<p><b>Original 2010 decision</b></p> <p>The methodology for estimating a vanilla WACC is:</p> $\text{cost of debt} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>The methodology for estimating a post-tax WACC is:</p> $\text{cost of debt (after corporate tax)} \times \text{leverage} + \text{cost of equity} \times (1 - \text{leverage})$ <p>See section 6.7, E2 of 2010 Airports IM reasons paper:</p> <p><a href="#">Input Methodologies (Airport Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Airports
<b>Decision CC27</b> <b>Term credit spread differential allowance may not be less than zero for a DPP</b>  <b>(2012 decision)</b>	<p><b>Original 2012 decision</b></p> <p>The TCSD should be set to a nil value if it would otherwise be negative.</p> <p>In 2012 we amended the TCSD allowance component of the cost of capital IM that applies to DPPs. This amendment sets out how we forecast a TCSD allowance during the regulatory period.</p> <p>See p. 25 and Attachment B of the 2012 reasons paper:</p> <p><a href="#">Specification and Amendment of Input Methodologies as Applicable to Default Price-Quality Paths: Reasons paper (28 September 2012)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

## Gas Pricing Methodologies IM decisions

<p><b>Decision GP06</b> Commission may amend a CPP gas pricing methodology annually</p>	<p><b>Original 2010 decision</b></p> <p>The Commission may amend a pricing methodology a maximum of once per year during the regulatory period. It may only do so where a GPB is proposing to make a material change to the pricing methodology specified in the CPP determination.</p> <p>See section 7.3, Appendix I of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>GDB/GTB</p>

## Specification of Price IM decisions

<p><b>Decision SP09</b> Pass-through costs – Transpower</p>	<p><b>Original 2010 decision</b></p> <p>The IM includes a list of pass-through costs and a process for adding new pass-through costs.</p> <p>The list of path-through costs includes local authority rates and regulatory levies.</p> <p>See section 7.3 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<p><b>This original decision applies to (sector):</b></p>	<p>Transpower</p>

<p><b>Decision SP11</b> Recoverable cost for additional revenue – Alpine/Top Energy/Centralines  (2014 decision)</p>	<p><b>Original 2014 decision</b></p> <p>This amendment introduces a recoverable cost to allow for a one-off recovery of additional revenue for three EDBs (Alpine Energy, Top Energy and Centralines).</p> <p>This amendment addresses the impact of the limit to price increases for Alpine Energy, Top Energy and Centralines in the last 2 years of the current regulatory period (1 April 2013 – 31 March 2015).</p> <p>The amendment changes the definitions in the general provisions of the IMs, and the IMs that apply for the specification of price for both DPPs and CPPs.</p> <p>It will apply from 1 April 2015, which corresponds to the start of the next DPP regulatory period:</p> <p><a href="#">Input methodology amendments for electricity distribution services: Default price-quality paths (Reasons paper) (27 November 2014)</a></p>
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<b>This decision applies to (sector):</b>	EDBs (Alpine Energy, Top Energy and Centralines only)
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### Reconsideration of the price-quality path IM decisions

<p><b>Decision RP07</b> Annual reconsideration for effect of major capex and listed projects – Transpower  (original decision amended)</p>	<p><b>Original 2010 decision</b> Transpower's IPP will be reconsidered annually to take account of the revenue impact of major capex approved by the Commission; and an economic value (EV) adjustment.  See section 7.4 of 2010 Transpower IM reasons paper:  <a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p> <p><b>2014 amendment to this decision</b> The amendment provides a mechanism for Transpower to apply for, and the Commission to approve, additional base capex for inclusion within Transpower's price path during a regulatory period in respect of large scale replacement and refurbishment projects, which are referred to as 'listed projects'.  The amendments took effect when they were published by notice in the <i>Gazette</i>, on 27 November 2014:  Amended the price path reconsideration provision in the Transpower IM to accommodate the revenue impact of approved base capex in respect of listed project assets that are forecast to be commissioned in a regulatory period.  <a href="#">Amendments to input methodologies for Transpower to provide a listed project mechanism: Reasons paper (27 November 2014)</a></p>
<b>This decision applies to (sector):</b>	Transpower

## Amalgamation IM decisions

<p><b>Decision AM01</b> No price reset following amalgamation</p>	<p><b>Original 2010 decision</b></p> <p>The primary purpose of the IM covering amalgamations during a regulatory period is to provide certainty to suppliers that the Commission will not reset their prices until the end of the DPP or CPP regulatory period in which the transaction occurs. It is also intended to provide certainty as to when two (or more) price-quality paths should be amalgamated following a transaction.</p> <p>See section 8.6, paragraph 8.6.1 of 2010 EDB-GPB IM reasons paper: <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

<p><b>Decision AM02</b> Suppliers to aggregate price-quality paths on amalgamation</p>	<p><b>Original 2010 decision</b></p> <p>If a supplier amalgamates with another supplier of the same type of regulated service, the Commission will not reconsider the existing price-quality path but will require the suppliers involved in the amalgamation to aggregate price-quality paths for compliance purposes from the start of the disclosure year following the amalgamation (if both regulated suppliers are subject to a DPP) or at the expiry of a CPP (if one or more of the regulated suppliers are subject to a CPP).</p> <p>See section 8.6, 8.6.2 of 2010 EDB-GPB IM reasons paper: <a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<p><b>This decision applies to (sectors):</b></p>	<p>EDB/GDB/GTB</p>

<p><b>Decision AM03</b> Amalgamation rule for existing CPPs</p>	<p><b>Original 2010 decision</b></p> <p>Where one or more parties to the amalgamation are already subject to a CPP at the time of the amalgamation, a joint CPP may not apply to the amalgamated supplier until the supplier(s) on a CPP have each completed at least 3 years of their CPP regulatory period (where applicable) by the time the new CPP is to take effect. In this circumstance, the regulatory period of any existing CPP would be shortened from 4 or 5 years to 3 or 4 years (terminating on the day before the new CPP will apply).</p> <p>The change would be given effect through an amendment to the existing regulatory period(s) specified in the relevant s 52P determinations. A supplier must complete at least 3 years of its CPP because of the requirement in s 53W(2) that:</p> <p style="text-align: center;">the Commission may set a shorter period than 5 years if it</p>
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	<p>considers this would better meet the purpose of this Part, but in any event may not set a term less than 3 years.</p> <p>See section 8.6, 8.6.3 of 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

### IRIS IM decisions

<b>Decision IR03</b> <b>Five-year retention of efficiency gains</b>	<p><b>Original 2010 decision</b></p> <p>The length of time suppliers are allowed to retain the efficiency gain is 5 years.</p> <p>See section 8.5, Appendix J, section J3 for 2010 EDB-GPB IM reasons paper:</p> <p><a href="#">Input Methodologies (Electricity Distribution and Gas Pipeline Services): Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	EDBs

<b>Decision IR07</b> <b>RCP1 IRIS transition – Transpower</b>	<p><b>Original 2010 decision</b></p> <p>In the first year of RCP1 no IRIS will be implemented.</p> <p>See section 7.5 of 2010 Transpower IM reasons paper:</p> <p><a href="#">Input Methodologies (Transpower) Reasons Paper (22 December 2010)</a></p>
<b>This decision applies to (sector):</b>	Transpower

460. IM decision IR07 has been deleted, as it was only applicable in the first year of Transpower's first regulatory period, RCP1.

## Other regulatory rules and processes IM decisions

<b>Decision RR01</b> <b>Treatment of periods that are not 12-month periods – DPP</b>	<p><b>Original 2012 decision</b></p> <p>Where the start or end date of any disclosure year is not aligned with the start or end date of a DPP regulatory period, the Commission may apply the input methodologies modified to the extent necessary to account for the change in length of the disclosure year.</p> <p>See p. 25 of the 2012 reasons paper:</p> <p><a href="#">Specification and Amendment of Input Methodologies as Applicable to Default Price-Quality Paths - Reasons Paper (28 September 2012)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

461. In its submission on our draft decision, First Gas supported our proposal to keep this decision unchanged.<sup>142</sup>

<b>Decision RR02</b> <b>Availability of Information – DPP</b>	<p><b>Original 2012 decision</b></p> <p>Where information necessary to calculate any base year or disclosure year amounts has not been disclosed by the supplier, in setting a DPP the Commission may rely either on information disclosed under an ID Determination, prior ID requirements, or information obtained under a s 53ZD request.</p> <p>See para 72.2 of the 2012 reasons paper:</p> <p><a href="#">Specification and Amendment of Input Methodologies as Applicable to Default Price-Quality Paths - Reasons Paper (28 September 2012)</a></p>
<b>This decision applies to (sectors):</b>	EDB/GDB/GTB

462. In its submission on our draft decision, First Gas supported our proposal to keep this decision unchanged.<sup>143</sup>

<sup>142</sup> First Gas “Submission on Input Methodologies review draft decisions (excluding cost of capital)” (4 August 2016), p. 6.

<sup>143</sup> First Gas “Submission on Input Methodologies review draft decisions (excluding cost of capital)” (4 August 2016), p. 6.

## Attachment A: Index of pre-review IM decisions

### Purpose of this attachment

463. The purpose of this attachment is to assist readers in navigating this report by:

463.1 listing all pre-review IM decisions in sequence according to their unique code;  
and

463.2 indicating where each pre-review IM decision is located in this report.

**Table A1: Cost allocation**

Decision	Short title	Applies to (sectors)	Where located in this Report
CA01	Allocating directly attributable cost	EDB/GDB/GTB	Part 3
CA02	Allocating not directly attributable cost	EDB/GDB/GTB	Part 1
CA03	Process for deciding allocation approach	EDB/GDB/GTB	Part 1
CA04	ABAA causal relationship approach and proxy allocators	EDB/GDB/GTB	Part 1
CA05	Definition of causal relationships	EDB/GDB/GTB	Part 2
CA06	Variation to three allocation approaches	EDB/GDB/GTB	Part 3
CA07	No cost allocation for common costs – Transpower	Transpower	Part 3
CA08	Operating costs must be adjusted for system operator costs – Transpower	Transpower	Part 3
CA09	Costs associated with new investment contracts – Transpower	Transpower	Part 3
CA10	Allocating directly attributable cost – Airports	Airports	Part 3
CA11	Allocating not directly attributable cost – Airports	Airports	Part 2

CA12	Causal relationship approach and proxy allocators – Airports	Airports	Part 1
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**Table A2: Asset valuation**

Decision	Short title	Applies to (sectors)	Where located in this Report
AV01	Initial RAB values for EDBs and GPBs	EDB/GDB/GTB	Part 3
AV02	Adjustments to initial RAB values	EDB/GDB/GTB	Part 3
AV03	RAB roll forward with indexation	EDB/GDB/GTB	Part 2
AV04	RAB exclusions	EDB/GDB/GTB	Part 2
AV05	Finance leases and intangible assets	EDB/GDB/GTB	Part 1
AV06	Commissioned assets added to RAB	EDB/GDB/GTB	Part 2
AV07	Network spares	EDB/GDB/GTB	Part 3
AV08	Easement rights	EDB/GDB/GTB	Part 2
AV09	Capital contributions	EDB/GDB/GTB	Part 1
AV10	Vested assets	EDB/GDB/GTB	Part 3
AV11	Lost and found assets	EDB/GDB/GTB	Part 3
AV12	Assets purchased from regulated supplier	EDB/GDB/GTB	Part 1
AV13	Financing costs on works under construction – excludes exempt EDBs	EDB/GDB/GTB	Part 1
AV14	Financing costs on works under construction – exempt EDBs	Exempt EDBs	Part 1
AV15	Revenues received on works under construction	EDB/GDB/GTB	Part 3
AV16	Straight line depreciation applies	EDB/GDB/GTB	Part 3

AV17	Standard asset lives apply – with listed exceptions	EDB/GDB/GTB	Part 1
AV18	Assets retained in RAB for ID	EDB/GDB/GTB	Part 2
AV19	Cost allocation applies to unallocated RAB	EDB/GDB/GTB	Part 3
AV20	Initial RAB values – Transpower	Transpower	Part 3
AV21	Pseudo asset in initial RAB – Transpower	Transpower	Part 3
AV22	RAB exclusions – Transpower	Transpower	Part 3
AV23	System operator assets excluded from RAB – Transpower	Transpower	Part 3
AV24	New investment contract assets valued at zero – Transpower	Transpower	Part 3
AV25	Finance leases and intangible assets – Transpower	Transpower	Part 3
AV26	No indexation of RAB – Transpower	Transpower	Part 2
AV27	Commissioned assets added to RAB – Transpower	Transpower	Part 2
AV28	Network spares – Transpower	Transpower	Part 3
AV29	Asset disposals – Transpower	Transpower	Part 2
AV30	Easements – Transpower	Transpower	Part 3
AV31	Lost and found assets – Transpower	Transpower	Part 3
AV32	Purchase of assets from regulated supplier or related party – Transpower	Transpower	Part 1
AV33	Financing costs on works under construction – Transpower	Transpower	Part 1

AV34	Straight line depreciation applies – Transpower	Transpower	Part 3
AV35	Standard physical asset lives to apply with exceptions – Transpower	Transpower	Part 1
AV36	Stranded assets – Transpower	Transpower	Part 3
AV37	Asset lives when asset is coming to end of life – Transpower	Transpower	Part 3
AV38	Cost allocation applies to unallocated RAB – Transpower	Transpower	Part 3
AV39	Initial RAB values for non-land assets – Airports	Airports	Part 3
AV40	RAB roll forward with indexation – Airports	Airports	Part 1
AV41	Initial RAB values for land assets and revaluation approach – Airports	Airports	Part 1
AV42	RAB exclusions – Airports	Airports	Part 1
AV43	Financing costs on works under construction – Airports	Airports	Part 2
AV44	Finance leases and intangible assets – Airports	Airports	Part 3
AV45	Commissioned assets added to RAB – Airports	Airports	Part 3
AV46	Purchase of assets from regulated supplier or related party – Airports	Airports	Part 1
AV47	Lost and found assets – Airports	Airports	Part 3
AV48	Capital contributions and vested assets – Airports	Airports	Part 1
AV49	Easement rights – Airports	Airports	Part 3

AV50	Straight line depreciation applies with election to use non-standard approach – Airports	Airports	Part 1
AV51	Asset lives and limit on unallocated depreciation – Airports	Airports	Part 3
AV52	Stranded assets – Airports	Airports	Part 3
AV53	Cost allocation applies to unallocated RAB – Airports	Airports	Part 3
AV54	Initial RAB value – Powerco GDB	GDBs (Powerco only)	Part 1
AV55 (new)	Giving effect to IM decisions – applying alternative methodologies with equivalent effect – Airports	Airports	Part 1

**Table A3: Treatment of taxation**

Decision	Short title	Applies to (sectors)	Where located in this Report
TX01	Modified deferred tax approach applies – EDBs and GDBs	EDB/GDB	Part 1
TX02	Tax legislation and cost allocation to be applied – EDBs	EDBs	Part 1
TX03	Tax losses ignored	EDB/GDB/GTB	Part 3
TX04	Regulatory tax asset value of asset acquired	EDB/GDB/GTB	Part 1
TX05	Initial regulatory tax asset value	EDB/GDB/GTB	Part 3
TX06	Initial deferred tax balance is zero – EDBs and GDBs	EDB/GDB	Part 3
TX07	Tax effect of discretionary discounts and rebates – EDBs	EDBs	Part 3
TX08	Tax legislation and cost allocation to be applied – GDBs and GTBs	GDB/GTB	Part 1

TX09	Tax payable approach applies – GTBs	GTBs	Part 3
TX10	Tax payable approach applies – Transpower	Transpower	Part 3
TX11	Tax legislation and cost allocation to be applied – Transpower	Transpower	Part 3
TX12	Notional leverage for deductible debt interest – Transpower	Transpower	Part 3
TX13	Tax losses ignored – Transpower	Transpower	Part 3
TX14	Regulatory tax asset value of asset acquired – Transpower	Transpower	Part 2
TX15	Initial regulatory tax asset value – Transpower	Transpower	Part 3
TX16	Tax payable approach applies – Airports	Airports	Part 1
TX17	Tax legislation and cost allocation to be applied – Airports	Airports	Part 3
TX18	Notional leverage for deductible debt interest – Airports	Airports	Part 3
TX19	Tax losses ignored – Airports	Airports	Part 3
TX20	Regulatory tax asset value of asset acquired from another supplier- Airports	Airports	Part 1
TX21	Initial regulatory tax asset value – Airports	Airports	Part 3

**Table A4: Cost of capital**

Decision	Short title	Applies to (sectors)	Where located in this Report
CC01	Cost of capital defined as estimate of WACC	EDB/GDB/GTB	Part 2
CC02	WACC percentile	EDB/GDB/GTB	Part 2

CC03	Commission to publish annual WACC estimates	EDB/GDB/GTB	Part 1
CC04	Vanilla WACC and post-tax WACC estimation methodology	EDB/GDB/GTB	Part 3
CC05	Cost of debt in WACC estimates	EDB/GDB/GTB	Part 1
CC06	Term credit spread differential allowance may apply	EDB/GDB/GTB	Part 1
CC07	Cost of equity in WACC estimates	EDB/GDB/GTB	Part 1
CC08	Corporate tax rate in WACC estimates	EDB/GDB/GTB	Part 2
CC09	Commercially realistic estimates of WACC	EDB/GDB/GTB	Part 2
CC10	Date for determining price-quality path estimates of WACC – EDBs and Transpower	EDBs/Transpower	Part 1
CC11	Cost of capital defined as estimate of WACC – Transpower	Transpower	Part 2
CC12	WACC percentile – Transpower	Transpower	Part 2
CC13	Commission to publish annual WACC estimates – Transpower	Transpower	Part 1
CC14	Vanilla WACC and post-tax WACC estimation methodology – Transpower	Transpower	Part 3
CC15	Cost of debt in WACC estimates – Transpower	Transpower	Part 1
CC16	Term credit spread differential allowance may apply – Transpower	Transpower	Part 1
CC17	Cost of equity in WACC	Transpower	Part 1

	estimates – Transpower		
CC18	Corporate tax rate in WACC estimates – Transpower	Transpower	Part 2
CC19	Cost of capital defined as estimate of WACC – Airports	Airports	Part 1
CC20	Commission to publish annual WACC estimates – Airports	Airports	Part 1
CC21	Vanilla WACC and post-tax WACC estimation methodology – Airports	Airports	Part 3
CC22	Cost of debt in WACC estimates – Airports	Airports	Part 1
CC23	Term credit spread differential allowance may apply – Airports	Airports	Part 1
CC24	Cost of equity in WACC estimates – Airports	Airports	Part 1
CC25	Corporate tax rate in WACC estimate – Airports	Airports	Part 2
CC26	Commercially realistic estimates of WACC – Airports	Airports	Part 2
CC27	Term credit spread differential allowance may not be less than zero for a DPP	Airports	Part 3

**Table A5: Gas pricing methodologies**

Decision	Short title	Applies to (sectors)	Where located in this Report
GP01	Principles-based approach to gas pricing	GDB/GTB	Part 2
GP02	Pricing principles to be consistent with Gas Authorisation	GDB/GTB	Part 2
GP03	Pricing principles in the IM are to be used to measure consistency under ID	GDB/GTB	Part 2
GP04	No application of gas pricing IM to gas DPPs	GDB/GTB	Part 2
GP05	Gas pricing IM may apply to a CPP	GDB/GTB	Part 2
GP06	Commission may amend a CPP gas pricing methodology annually	GDB/GTB	Part 3

**Table A6: Specification of price**

Decision	Short title	Applies to (sectors)	Where located in this Report
SP01	Weighted average price cap applies – EDBs and GDBs	EDB/GDB	Part 1
SP02	Weighted average price cap or total revenue cap applies – GTBs	GTBs	Part 1
SP03	Pass-through costs – EDBs and GDBs	EDB/GDB	Part 1
SP04	Pass-through costs – GTBs	GTBs	Part 1
SP05	Recoverable costs – EDBs	EDBs	Part 1
SP06	Recoverable costs – GDBs	GDBs	Part 1
SP07	Recoverable costs – GTBs	GTBs	Part 1
SP08	Price specified by revenue cap – Transpower	Transpower	Part 2

SP09	Pass-through costs – Transpower	Transpower	Part 3
SP10	Recoverable costs – Transpower	Transpower	Part 2
SP11	Recoverable cost for additional revenue – Alpine/Top Energy/Centralines	EDBs (Alpine Energy, Top Energy and Centralines only)	Part 3

**Table A7: Reconsideration of the price-quality path**

<b>Decision</b>	<b>Short title</b>	<b>Applies to (sectors)</b>	<b>Where located in this Report</b>
RP01	Reconsideration of DPP	EDB/GDB/GTB	Part 1
RP02	Reconsideration of CPP	EDB/GDB/GTB	Part 1
RP03	Meaning of ‘material’ for purposes of reconsideration	EDB/GDB/GTB	Part 1
RP04	Reconsideration for contingent or unforeseen expenditure under a CPP – GTBs	GTBs	Part 1
RP05	Reconsideration of IPP – Transpower	Transpower	Part 1
RP06	Meaning of ‘material’ for purposes of reconsideration – Transpower	Transpower	Part 1
RP07	Annual reconsideration for effect of major capex and listed projects – Transpower	Transpower	Part 3

**Table A8: Amalgamations**

Decision	Short title	Applies to (sectors)	Where located in this Report
AM01	No price reset following amalgamation	EDB/GDB/GTB	Part 3
AM02	Suppliers to aggregate price-quality paths on amalgamation	EDB/GDB/GTB	Part 3
AM03	Amalgamation rule for existing CPPs	EDB/GDB/GTB	Part 3

**Table A9: IRIS**

Decision	Short title	Applies to (sectors)	Where located in this Report
IR01	IRIS to apply – EDBs	EDBs	Part 2
IR02	Treatment of IRIS balances – EDBs	EDBs	Part 1
IR03	Five-year retention of efficiency gains	EDBs	Part 3
IR04	IRIS to apply under an IPP – Transpower	Transpower	Part 2
IR05	Treatment of IRIS balances – Transpower	Transpower	Part 1
IR06	Five-year retention of efficiency gains – Transpower	Transpower	Part 2
IR07 (deleted) <sup>144</sup>	RCP1 IRIS transition – Transpower	Transpower	Part 3
IR08	IRIS to apply under a CPP – GDBs and GTBs	GDB/GTB	Part 1
IR09	Treatment of IRIS balances – GDBs and GTBs	GDB/GTB	Part 1

<sup>144</sup> IR07 has been deleted, as it was only applicable in the first year of Transpower's first regulatory period.

IR10	Five-year retention of efficiency gains	GDB/GTB	Part 1
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**Table A10: Other regulatory rules and processes IM decisions**

Decision	Short title	Applies to (sectors)	Where located in this Report
RR01	Treatment of periods that are not 12-month periods – DPP	EDB/GDB/GTB	Part 3
RR02	Availability of Information – DPP	EDB/GDB/GTB	Part 3

**Table A11: CPP (all of these decisions are discussed in Topic paper 2: CPP requirements)**

Decision	Short title
CP01	Price path information
CP02	Expenditure information – qualitative
CP03	Expenditure information – quantitative
CP04	Period of information required
CP05	Detail on material projects and programmes
CP06	Information relevant to prices
CP07	Verification report
CP08	Audit and assurance report
CP09	Consumer consultation evidence
CP10	Certification
CP11	Modification or exemption of CPP application requirements
CP12	Information regarding quality
CP13	Cost allocation information
CP14	Asset valuation information
CP15	Tax information
CP16	Information relevant to alternative methodologies
CP17	Cost of capital information

CP18	Gas pricing methodology to be submitted with CPP proposal – GDBs and GTBs
CP19	General matters
CP20	Quality-only CPP
CP21	Verification requirements
CP22	Audit and assurance requirements
CP23	Consumer consultation requirements
CP24	Certification requirements
CP25	Reconsideration of a CPP (not an IM decision - included for reference purposes only – refer to IM decision RPO2)
CP26	Modification or exemption of CPP application requirements
CP27	Evaluation criteria
CP28	Determination of annual allowable revenues
CP29	Cost allocation and asset valuation
CP30	Treatment of taxation
CP31	Cost of capital
CP32	Alternative methodologies with equivalent effect

## Attachment B: Next closest alternative provision

### Purpose of this attachment

464. The purpose of this attachment is to explain why we have decided not to adopt the next closest alternative (**NCA**) provision that we proposed in our draft decision.<sup>145</sup>

### We proposed an NCA provision as part of our draft decisions

465. In our draft decision, we proposed making a new IM decision to allow for an alternative approach to be applied in respect of matters covered by an existing IM when that IM becomes unworkable. That proposal is explained in Chapter 3 in our draft report on the IM review.<sup>146</sup>

### We decided not to adopt the NCA provision as part of our final decision

466. We have removed the proposed next closest alternative provisions and associated reopeners that we proposed in our draft decision. We proposed and consulted on this change from our draft decision in our technical consultation update paper.<sup>147</sup> We consider that the issues the provisions were introduced to solve can, in most cases, be appropriately addressed through the IM amendments process. On balance, we do not consider that the benefits of the added flexibility outweigh the potential uncertainty that it may introduce.<sup>148</sup>

467. We did identify one particular situation where a reconsideration provision is required to address an unworkable IM. This is where an IM is rendered unworkable due to a regulatory or legislative change, and the change does not result in costs that meet the materiality threshold for the change event reopener.

468. To address this situation, we have introduced an exception to the materiality threshold for the change event reopener where the change event results in an IM being incapable of being applied. We consulted on this change in our technical consultation update paper.<sup>149</sup> This change is described in our decisions on IM decisions RP03 and RP06.

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<sup>145</sup> See proposed new decision GE01 in Commerce Commission "Input methodologies draft decisions: Report on the IM review (22 June 2016).

<sup>146</sup> See proposed new decision GE01 in Commerce Commission "Input methodologies draft decisions: Report on the IM review (22 June 2016).

<sup>147</sup> Commerce Commission "Input methodologies review – Technical consultation update paper" (13 October 2016), p. 7.

<sup>148</sup> A number of submissions on our draft decision suggested that the introduction of these provisions was likely to increase regulatory uncertainty. See, for example: Vector "Submission to Commerce Commission on the IM review draft decision and IM report" (4 August 2016), p. 31.

<sup>149</sup> Commerce Commission "Input methodologies review – Technical consultation update paper" (13 October 2016).

## Attachment C: Reopener provision for live-line work

### Purpose of this attachment

469. This attachment responds to a letter received from the ENA and to submissions on our technical consultation update paper that requested changes to the reopener provisions for default and customised paths to take account of proposed changes to the circumstances in which suppliers undertake live-line work.

### Request for changes to take account of proposed guidelines for live-line work

470. On 13 October 2016 we received a letter from the ENA setting out a number of concerns relating to Part 4 of the Commerce Act regarding the implementation of the Health and Safety at Work Act 2015 (“the Health and Safety Act”).<sup>150</sup> As a consequence of the Health and Safety Act, the electricity supply industry is preparing guidelines that will set safe working practices regarding work on high voltage equipment. The ENA suggested that certain changes being proposed as part of the IM review provided an opportunity to deal with the issues raised by the change in legislation and the subsequent draft guidelines, which the ENA had provided to Worksafe for review.

471. We published the letter and requested stakeholders to provide comments on it as part of their submissions on our technical consultation update paper.

472. In its letter, the ENA stated that the draft guidelines start off with the presumption that all work should be undertaken de-energised, which will limit the circumstances when live work could be done. In ENA’s view, this would impact the SAIDI and SAIFI indices, and could alter non-exempt EDBs’ ability to achieve their quality standards, thereby increasing the likelihood of incurring penalties under the DPP quality incentive scheme. In the case of Orion, there would be an increased likelihood of breaching its CPP.<sup>151</sup>

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<sup>150</sup> Letter from Graeme Peters (Chief Executive, ENA) to Sue Begg (Deputy Chair, Commerce Commission) regarding the impact of a reduction of live line work on non-exempt EDBs under the default and customised price quality path (October 2016), Commerce Commission "Notification email – Letter received from ENA on the impact of a reduction of live line work on non-exempt EDBs under the default and customised price quality path" (20 October 2016).

<sup>151</sup> Letter from Graeme Peters (Chief Executive, ENA) to Sue Begg (Deputy Chair, Commerce Commission) regarding the impact of a reduction of live line work on non-exempt EDBs under the default and customised price quality path (October 2016).

473. The ENA also set out its view that the new quality standard reopener for the DPP, as proposed in our draft IM review decisions, would be useful to address the change in circumstances brought about by the Health and Safety Act, if that reopener was available within the current regulatory period.<sup>152</sup> Subsequently, however, in its submission on the update paper, ENA did not dispute our view that the new quality standard reopener could not apply before 1 April 2020, due to the requirements of s 53ZB.
474. Therefore, as an alternative, the ENA submitted that the existing change event reopener for DPPs and CPPs could be used if it was modified slightly by removing (or amending) the materiality threshold for change events that affect quality standards. They suggested a quality-specific threshold, such as an event that changes SAIDI or SAIFI by 3% per annum for the remainder of the regulatory period. In the ENA's view, that change to the reopener provisions could and should be made to apply in the current regulatory period.<sup>153</sup>
475. ENA also suggested that a more straightforward option could be for us to amend the DPP quality standards under s 52Q, given that the method for setting quality standards is not specified in the IMs.
476. Vector supported the ENA's recommendations for more flexibility for the reopeners, and also suggested that we could use our powers under s 52Q to amend the DPP determination to ensure quality standards for non-exempt EDBs reflect the new live-line limitations under the Health and Safety Act. In Vector's view, CPP applications would not be an appropriate alternative option.<sup>154</sup>
477. By contrast, MEUG submitted that tabling the ENA letter so late in the process was not conducive to effective feedback from resource constrained consumers. MEUG recommended that a prudent course of action would be to park ENA's proposals for consideration until the current IM review has concluded. In addition, MEUG did not support amending the IM to have a quality standard reopener to apply to the DPP and CPP, as in MEUG's view the design philosophy for DPPs and CPPs are *ex-ante* "set and forget" incentive regimes. Reopeners should be kept to a minimum by having a materiality test to avoid intra-RCP 'gaming' or 'cherry-picking'.

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<sup>152</sup> Letter from Graeme Peters (Chief Executive, ENA) to Sue Begg (Deputy Chair, Commerce Commission) regarding the impact of a reduction of live line work on non-exempt EDBs under the default and customised price quality path (October 2016), para 10.

<sup>153</sup> Letter from Graeme Peters (Chief Executive, ENA) to Sue Begg (Deputy Chair, Commerce Commission) regarding the impact of a reduction of live line work on non-exempt EDBs under the default and customised price quality path (October 2016), para 10.

<sup>154</sup> Vector "Vector submission on electricity networks association letter on live line work impact for non-exempt electricity distribution businesses" (3 November 2016), para 10-14.

**We decided not to make changes as part of our final decision and will work with relevant parties going forward**

478. We agree, as ENA and Vector submit, that it is important to consider the implications of the Health and Safety Act for the regulatory regime under Part 4. However, we do not consider that s 52Q or the IM review process are the right tools to effect any further changes relating to this issue for several reasons.
479. First, we do not agree with ENA or Vector that we are able to use s 52Q to simply amend the DPP without one of the reopener provisions in the IMs, or in the Act, applying.<sup>155</sup> It is our view that given s 53ZB and 52T(3)(c)(ii) of the Act, that we are only able to exercise the powers under s 52Q, if one of the reopener provisions set out in the IMs or provided for under the Act is triggered.
480. Secondly, we consider that s 53ZB prevents us from applying the changes, made to the IM reopener provisions as part of the IM review, during the current regulatory period. The ENA's proposal is for the reopener provision to be amended within the IMs to allow for quality standards to be changed straight away and this, in our view, would run contrary to s 53ZB of the Act.
481. The ENA argues that s 53ZB would not be contravened because the reopening would not be due to the IM amendments but rather due to the proper application of the IM as amended. However, it is our view that this would defeat the purpose of s 53ZB, as it would mean that we could change core elements of a DPP/ CPP during a regulatory control period by simply amending the reopener provisions in the IMs to specify the change we wished to achieve and then apply the new IM to achieve that change. That would be the case whether the change is to introduce a new reopener, or to amend an existing one.
482. We consider that our interpretation of these provisions is consistent both with comments made in the High Court and with the objectives of Part 4.<sup>156</sup> In particular s 52R of the Act, which set outs the purpose statement for IMs, which is to promote certainty for suppliers and consumers in relation to the rules, and requirements and processes applying to the regulation of goods and services. To be able to make changes during a regulatory period, with no reopener provision having being triggered or through the change to a reopener provision, runs contrary to this purpose.

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<sup>155</sup> The Act provides for two specific situations where the Commission, upon request from either the Electricity Authority or the Gas Industry Company, can reconsider a section 52P determination, and amend it if the Commission considers it necessary or desirable. Refer to section 54V(5) and section 55I(3) of the Act.

<sup>156</sup> *Wellington International Airport Ltd v Commerce Commission* [2013] NZHC 3289 at [219] 3

483. We consider that the change proposed by the ENA to include a 3% materiality threshold for quality change events could deal with circumstances where a percentage change in revenue is not a useful or meaningful materiality threshold for a proposed change to a quality standard. However, ENA provided no information in support of the 3% value for the threshold, and other interested parties have not had the opportunity to comment on it. We also acknowledge MEUG's more general concern that ENA's views were provided very late in our IM review process, and therefore we should 'park' ENA's proposals until after the IM review.
484. Furthermore, given this amendment cannot apply for reopeners in the current regulatory period, they are unlikely to address ENA's concerns associated with live-line work. Consequently, at this stage, we have decided not to introduce a quality change event materiality threshold.
485. We acknowledge that more work on this area, including on the guidelines and by individual EDBs, is ongoing. We will work with the ENA, its members and Worksafe going forward and use the existing regulatory tools (including the legislation) as and when these are appropriate.

## Attachment D: Further explanation of the price setting and wash-up processes under a revenue cap

### Purpose of this attachment

486. The purpose of this attachment is to provide an illustrative example of how the price-setting and wash-up processes may work under a revenue cap in a DPP or CPP for a GTB or EDB.

### Background

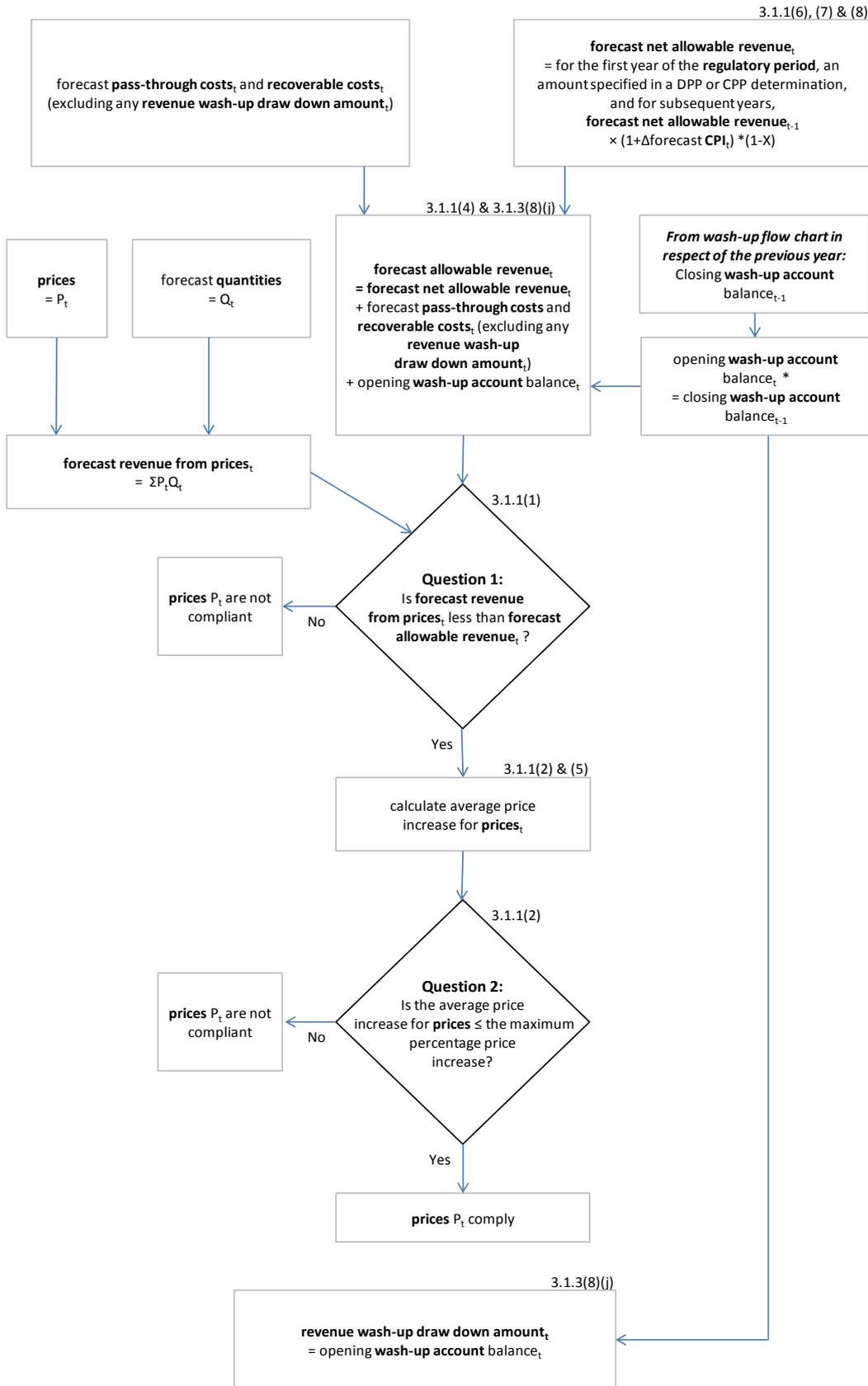
487. The flow charts in this attachment show, for illustrative purposes, a possible implementation of the specification of price input methodologies in a DPP or CPP determination for a GTB or EDB. The wash-up mechanism in particular reflects a possible implementation of the IMs, rather than a necessary approach. The flow charts have been updated from our technical consultation update paper of October 2016.<sup>157</sup>
488. The flow charts include the mechanism of a limit on average price increases. The IM determinations set this mechanism as an optional feature, with the DPP or CPP determination to specify whether and how it will be implemented.
489. We will consult on the compliance requirements for the GTB DPP in our February 2017 draft DPP decision. We expect to have a similar consultation for the 2020 EDB DPP reset or for any earlier EDB CPP.
490. The revenue cap mechanisms for EDBs would be similar to the GTB mechanisms, with an additional mechanism relating to voluntary undercharging, as discussed in Topic paper 1: Form of control and RAB indexation.
491. Bolded terms in the flow charts are defined in the relevant GTB and EDB determinations.

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<sup>157</sup> Commerce Commission "Input methodologies review – Technical consultation update paper" (13 October 2016).

Figure D1

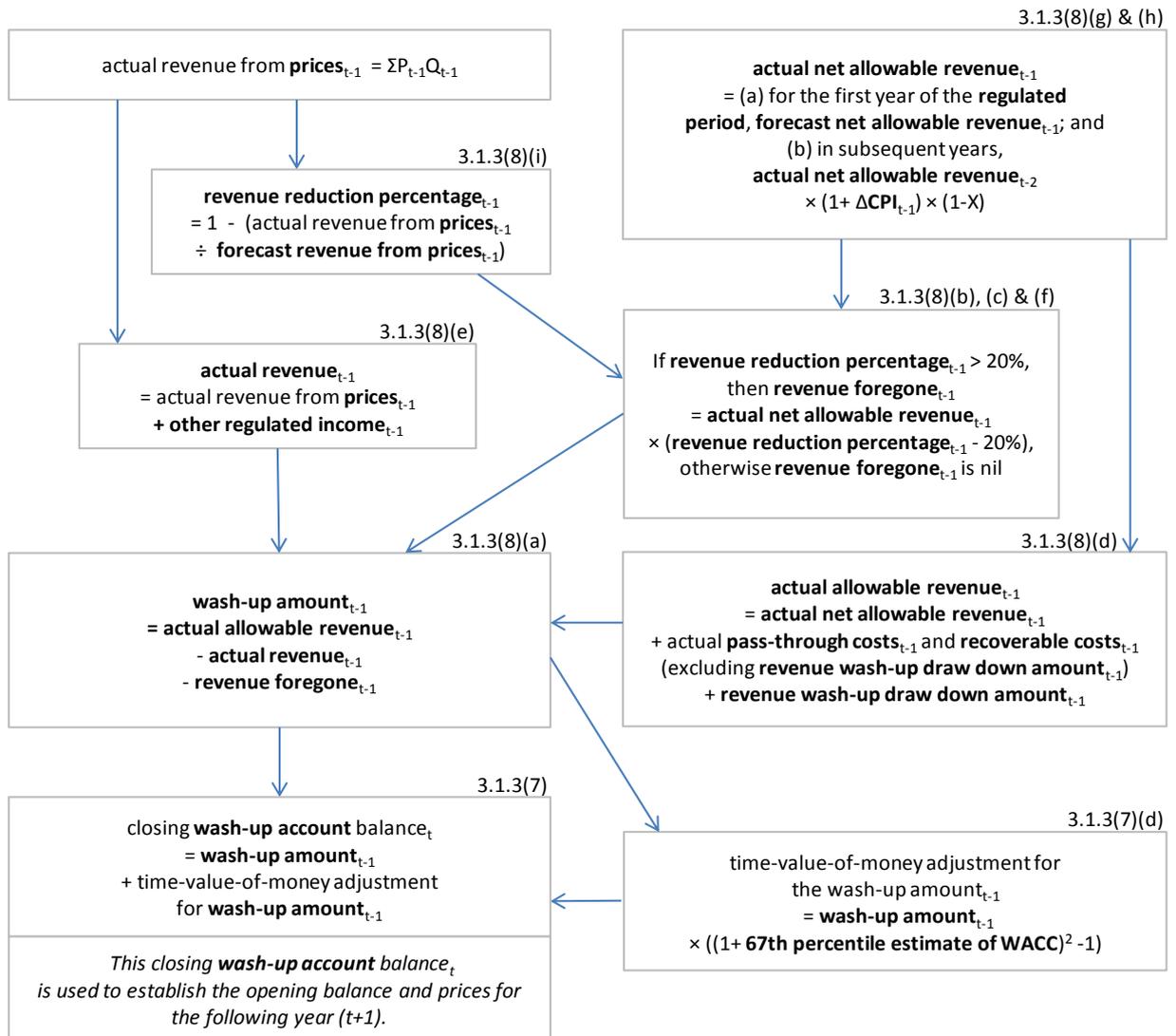
Setting prices and assessing compliance for Year t for a GTB



\* The opening wash-up account balance for Year t is the total amount in the wash-up account available to be drawn down in setting prices for the pricing year t.

Figure D2

**Determining the wash-up amount and the closing balance of the wash-up account for Year t for a GTB**



A positive wash-up amount indicates that the actual revenue received (plus any amount of revenue foregone) has been less than the actual allowable revenue. That positive balance would lead to a positive balance in the wash-up account, which would be in favour of the supplier.

To keep this flow chart simpler, we have assumed that the supplier fully draws down the opening balance of the wash-up account. Therefore the calculation for the closing wash-up account balance does not include the terms reflecting the opening wash-up account balance being fully drawn down by the revenue wash-up draw down amount.

This wash-up flow chart is the same for GTBs and EDBs, except that the wash-up amount for EDBs will account for any cap on the cumulative amount of voluntary under charging.

Cross-references to the EDB IM 52P determination may have different clause numbers.

## Attachment E: Timing and transition provisions in the IM amendments determinations

### Purpose of this attachment

492. The purpose of this attachment is to explain the timing and transition provisions we have included in the amendments determinations. These timing and transition provisions relate to when and how determination amendments made as a result of this IM review come into effect.
493. Our approach to the timing and transition provisions is to address the potential for complexity in making changes in different parts of the IM determinations and in having those changes apply at different times. Recognising that some complexity is unavoidable, the general intent of our drafting of these provisions is to make the key updated provisions of the IMs as accessible as possible.

### Structure of this attachment

494. In this attachment we explain:
- 494.1 our approach to timing and transition provisions; and
  - 494.2 what we have tried to achieve with our timing and transition provisions.
495. We then set out the specific timing and transition provisions we have included for each of the amendments determinations.

### Explanation of our approach

496. As a result of the IM review, we have published five IM amendments determinations, where we have marked our amendments to the determinations as tracked changes so that users of the determinations can identify all amendments in the context of the principal IM determinations.
497. We have also published a consolidated IM determination now for airports as it has fewer transition provisions.<sup>158</sup>
498. We intend to publish consolidated IM determinations for EDBs, GDBs, GTBs and Transpower in the first quarter of 2017. These consolidated determinations will consolidate the changes in the amendments determinations with the principal IM determinations, and will include transition information where applicable.<sup>159</sup>

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<sup>158</sup> We have published an airports ID amendments determination under s 52Q of the Act, and a consolidated airports ID determination. The amendments to the airports ID determination enter into force on publication.

<sup>159</sup> The consolidated IM determinations are provided for convenience and usability purposes.

499. Amendments to the IMs take effect on the day after notice is given in the New Zealand Gazette, which will be the 'commencement date'. This is 23 December 2016.
500. However, s 53ZB of the Act does not allow price-quality paths to be reopened during a regulatory period on the grounds of an IM amendment. Therefore, although the amendments will come into effect immediately, we consider that, under the Act, not all amendments can be applied immediately to suppliers.
501. There are also amendments that, from a practical perspective, are not able to be applied immediately to suppliers. For example, we may need to amend a s 52P determination before the IM amendments can apply to suppliers.<sup>160</sup> Therefore, there are some identified variations to the general rule about when the amendments are first to be applied.

### **Application of changes to instruments and sectors**

502. We describe below how our IM amendments in relation to our ID regulation, DPP regulation, IPP regulation and CPP regulation will apply.
503. We also describe below how our consolidated determinations will operate for each sector in light of the timing provisions in the amendments determinations.

#### *Amendments to the airports IM determination in relation to ID regulation*

504. Our amendments to the Airport IMs determination for ID regulation apply from the date on which the amendments determination takes effect - 23 December 2016.
505. IM amendments will apply for airports from the commencement date in the airports IM determination, as the IM amendments apply to certain disclosure requirements in the airports ID determination, to which we have also made amendments which enter into force at the same time as the IM amendments. As such, there is no period for which the IM amendments would be in force but not yet applicable.<sup>161</sup>

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<sup>160</sup> See discussion on amendments in relation to ID requirements in para 514-517 and quality-only CPPs in para 510-513.

<sup>161</sup> Most of the amendments to the Airports ID determination are to the forward looking disclosure requirements, which will be applied at the next price setting event. This is in 2017 for Christchurch and Auckland Airports. There are some minor amendments to the backward looking disclosures which will be applied for the 2017 disclosure year for all airports.

*Amendments in relation to CPP proposals*

506. Amendments to the EDB, GDB and GTB IMs in relation to new CPP proposals will apply from the date on which the EDB, GDB and GTB IM amendments determinations take effect – 23 December 2016. We will consider dealing with any transition issues for individual CPP applicants through the use of the modification and exemption provisions on a case-by-case basis.
507. IM amendments in relation to CPP proposals generally apply from the date the amendment determinations take effect.<sup>162</sup> However, EDBs, GDBs and GTBs may want to propose a CPP at any time after the IM amendments come into effect. This means that any CPP application submitted to us after the commencement date must apply the updated CPP requirements in our amended IM determinations.
508. An applicant can apply for a modification or exemption under the IM rules for CPP proposals. In submissions on our technical consultation, ENA supported our proposal to allow amendments in relation to CPP proposals to apply from the date the amendments determinations take effect.<sup>163</sup>
509. We have decided that the CPP amendments will apply immediately. This should assist potential CPP applicants.
510. Notwithstanding that general rule, our amendments to remove the ability to apply for a quality-only CPP for EDBs will not apply until the start of the next EDB regulatory period, beginning on 1 April 2020.
511. This is because, as described below, we do not consider that amendments to reconsideration provisions in relation to DPP regulation are able to apply until 1 April 2020. This means that our amendment to include a quality-only DPP reopener for EDBs will not be available until 1 April 2020.
512. To avoid a gap in the ability of an EDB that is subject to a DPP to apply for a quality-only variation to their price-quality path, we have therefore allowed those EDBs to retain the opportunity to apply for a quality-only CPP until the new quality reopener provision comes into effect at the next DPP reset. We have retained a quality-only CPP in the EDB IM determination until 31 March 2020.

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<sup>162</sup> Although the CPP provisions come into effect immediately, this does not breach s 53ZB as it will not lead to a price path being reopened. Rather, a CPP sets a new path.

<sup>163</sup> ENA “Input methodologies review: Technical consultation update paper: Submission to the Commerce Commission” (3 November 2016), para 15-17.

513. This allows suppliers to apply for a quality-only CPP up until 12 months prior to the next EDB DPP reset. If an EDB subject to a DPP applies for a quality-only CPP, we will work with the applicant to ensure cost and complexity are minimised, consistent with our intention to move to a lower cost approach for assessing quality variations. The modification and exemption provisions will be available if needed to achieve this.

*Amendments in relation to ID regulation*

514. Amendments to the EDB, GDB, GTB and Transpower IM determinations cannot be applied under their respective ID determinations until each ID determination is amended to incorporate our changes to the IM determinations.<sup>164</sup> The IM amendments in relation to ID regulation apply from the first disclosure year after the applicable ID determination is amended.<sup>165</sup>
515. We consider that having the IM changes in relation to the ID determinations apply immediately could cause compliance issues for suppliers. As some of our requirements, defined terms, and formulas in the ID determinations are drafted with reference to the pre-review IMs, there would be inconsistencies with the IM amendments determinations until such time as each of the ID determinations is updated.
516. We will be aiming within our overall work programme to update the reporting requirements in each of the EDB, GDB, GTB and Transpower ID determinations by the end of 2017 to incorporate amendments made to the applicable IM determinations. Our working assumption is that if that timetable can be achieved, the IM amendments for ID determinations would apply for the 2018-2019 disclosure year in each case.

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<sup>164</sup> The EDB, GDB and GTB ID determinations define 'IM determination' for this purpose as the determination in force when the ID determination comes into force. This provides regulatory certainty for suppliers on the IMs that will apply for disclosures, which allows, for example, the design of reporting systems on a timely basis to meet the ID requirements.

<sup>165</sup> In submissions on our technical consultation, ENA and Powerco indicated that there was an inconsistency between our revised draft IM determinations and our description of the proposed change in our technical consultation update paper for when amendments in relation to ID regulation (except cost allocation) would apply. Transpower also suggested drafting changes to the equivalent clause in the Transpower IM determination: ENA "Input methodologies review: Technical consultation update paper: Submission to the Commerce Commission" (3 November 2016), para 15-17; Powerco "Submission on Input methodologies review: Technical consultation update paper" (3 November 2016), p. 12; and Transpower "[REVISED DRAFT] Transpower Input Methodologies Amendments Determination 2016" (3 November 2016", clause 1.1.2(3)(a).

517. For example, if the EDB, GDB and GTB ID determinations are updated before 1 April 2018, the EDB, GDB and GTB IM amendments in respect of cost allocation would apply when completing asset management plans (**AMP**) or AMP updates for the disclosure year 2019 and later disclosure years. This would mean that an EDB which is required to complete an AMP for the 2019 disclosure year before 1 April 2018 would need to do so using the amended cost allocation IM.
518. In submissions on our technical consultation, Wellington Electricity submitted that our amendments in respect of cost allocation should apply from disclosure year 2020.<sup>166</sup> It suggested that having the ACAM removal apply from the beginning of disclosure year 2019 'is not sufficient to implement the anticipated system and process change requirements'.<sup>167</sup>
519. We consider that having the amendments to the cost allocation provisions apply from the beginning of disclosure year 2019 will ensure that the cost allocation method used for the first year of the next EDB DPP period is consistent with the price-quality path and ID. We consider that it is useful for analysis purposes to have at least one base year of data under the existing EDB DPP regulatory period (2015-2020) for the setting of the price-quality path for the next EDB DPP regulatory period (2020-2025). Having the amendments to the cost allocation provisions apply from the beginning of disclosure year 2019 (eg, 1 April 2018 for EDBs) provide suppliers with more than a year to change their systems if necessary.
520. We considered the alternative of applying these amendments in relation to ID regulation from the start of the next EDB DPP regulatory period (or in the case of Transpower, the next IPP regulatory period) to keep the IMs used under the current price-quality determinations aligned on a year-by-year basis with ID. This would eliminate a situation of us receiving data for the evaluation of the performance of EDBs or Transpower under new IM requirements while the entities are still subject to the old IM rules for the purposes of prices and revenues up to the next resets in 2020.
521. However, based on our IM amendment decisions, we do not consider that the differences are likely to be material for the purpose of performance measurement. We therefore consider that it is more workable for the next EDB and Transpower price-quality path resets to have the ID and IM amendments apply when the next ID determination amendments are made.

*Amendments in relation to DPP regulation and IPP regulation*

522. Amendments in relation to DPP regulation and IPP regulation apply:

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<sup>166</sup> Wellington Electricity "Input Methodologies Review: Response to technical consultation update paper" (3 November 2016), para 5.

<sup>167</sup> Wellington Electricity "Input Methodologies Review: Response to technical consultation update paper" (3 November 2016), para 5.

- 522.1 for EDBs, for the setting and monitoring of DPPs having an EDB regulatory period commencing from 1 April 2020 (ie, the start of the next EDB regulatory period);
- 522.2 for GDBs, for the setting and monitoring of DPPs having a GDB regulatory period commencing from 1 October 2017 (ie, the start of the next GDB regulatory period);
- 522.3 for GTBs, for the setting and monitoring of DPPs having a GTB regulatory period commencing from 1 October 2017 (ie, the start of the next GTB regulatory period); and
- 522.4 for Transpower, for the setting and monitoring of the IPP for the IPP regulatory period commencing from 1 April 2020 (ie, the start of Transpower's next regulatory period, RCP3).
523. Amendments to DPP and IPP regulation apply for use in future price-quality resets, as this provides certainty for suppliers that are subject to price-quality paths currently in force.
524. For the avoidance of doubt, any amendments to the reopener provisions, pass-through cost provisions, and recoverable cost provisions in relation to DPP and IPP regulation will not apply until the start of the next applicable regulatory period unless (in the case of EDBs, GDBs and GTBs), a CPP proposal is made in the meantime.<sup>168</sup>
525. In its submission on our technical consultation, Transpower proposed including a clause in the Transpower IM determination that would allow references to legislation or determinations to automatically update after amendments occur to the specified legislation or determinations that are referenced in the Transpower IM determination.<sup>169</sup> We do not consider that Transpower's proposal is workable, particularly for the updating of references that apply to the price-quality path in force at the time any reference changes.<sup>170</sup>
526. As the amendments in relation to DPP and IPP regulation will be used for future price-quality path resets, we have specifically allowed for the amendments to apply before the commencement of each regulatory period for the purpose of calculating forecast values that would apply in the regulatory period, and to allow us to use those forecast values in determining the DPPs or the IPP.

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<sup>168</sup> This is consistent with limitations that apply to the reopening of price-quality paths under s 53ZB of the Act as a result of an IM amendment. See earlier discussion in para 480-482.

<sup>169</sup> Transpower "[REVISED DRAFT] Transpower Input Methodologies Amendments Determination 2016" (3 November 2016", Clause 1.1.4(1)(c).

<sup>170</sup> Our understanding of s 53ZB is that updating any references in respect of the price-quality path in the IM determination will not apply until the next price-quality path, unless the price-quality path is reconsidered under one of the reopening provision in the IMs.

527. In its submission on our technical consultation, Transpower proposed removing redundant clauses no longer in effect in relation to IPP regulation.<sup>171</sup> We have removed these clauses.

*Consolidated IM determinations*

528. We have published an updated consolidated IM determination for airports which incorporates the changes in our airports IM amendments determination into the principal airports IM determination. We intend to publish updated consolidated IM determinations for EDBs, GDBs, GTBs and Transpower in the first quarter of 2017, which will incorporate the changes our IM amendments determinations into the principal IM determinations.
529. Because our amendments in relation to ID regulation for EDBs, GDBs, GTBs and Transpower will apply after the applicable ID determinations are amended, we will provide an appendix in the consolidated IM determinations, which will set out any superceded ID-related provisions in the IMs which may continue to apply for a period after the applicable ID determinations are amended.
530. That appendix to the consolidated determinations will allow users of the IM determinations to identify which provisions currently apply and when they will be required to apply amendments resulting from the IM review. All IM amendments in relation to ID regulation that will apply in the future will be incorporated in the body of the consolidated IM determinations.
531. Our consolidated EDB IM determination will include in its appendix the 'quality-only' CPP provisions which continue to apply until 31 March 2020.<sup>172</sup>
532. As our amendments in relation to ID regulation for airports apply immediately, our consolidated airports IM determination does not include a transition appendix.
533. Tables E1-E5 below briefly explain the timing and transition provisions we have included in the amendments determinations and indicate where in the amendments determinations they are located.

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<sup>171</sup> Transpower "[REVISED DRAFT] Transpower Input Methodologies Amendments Determination 2016" (3 November 2016", p. 5-6, 12, 16, 51-53.

<sup>172</sup> See paras 51010-513 .

**Table E1: Timing and transition in IM amendments determination for EDBs**

Explanation of timing and transition provisions	Clause reference in amendments determination
IM amendments in relation to cost allocation for ID regulation will apply from the commencement of disclosure year 2019.	1.1.2(4)(a)
IM amendments in relation to ID regulation for asset valuation, the treatment of taxation, and the cost of capital will apply in respect of the first disclosure year after the next amendment to the ID determination made after the commencement date of the IM amendments.	1.1.2(4)(b)
IM amendments in relation to DPP regulation will apply for DPPs in force from 1 April 2020. Compliance with the current DPP will apply the pre-review IMs (even after 1 April 2020, in respect of compliance requirements in the current DPP).	1.1.2(4)(c)(i), 1.1.2(4)(d)
IM amendments in relation to CPP regulation will apply for CPP proposals submitted to us after the commencement date of the IM amendments determination. <sup>173</sup>	1.1.2(4)(c)(ii), 1.1.2(4)(e)
Quality-only CPP provisions and any other necessary associated provisions will apply until 31 March 2020.	1.1.2(4)(f)
IM amendments relating to forecast values or to matters required to be carried out by a supplier or the Commission for a DPP that will be in force from 1 April 2020 will apply from the commencement date of the IM amendments determination.	1.1.2(5)
IM amendments for cost allocation in relation to forecast values or matters required to be carried out by a supplier or the Commission in respect of a DPP to be determined after the commencement date will apply from the commencement date of the IM amendments determination.	1.1.2(6)

<sup>173</sup> To give practical effect as soon as possible to the IM amendments on the TCSD mechanism, the EDB CPP IMs allow the TCSD changes to apply for CPP proposals submitted to us after the commencement date of the EDB IM amendments determination.

**Table E2: Timing and transition in IM amendments determination for GDBs**

Explanation of timing and transitional provisions	Clause reference in amendments determination
IM amendments in relation to cost allocation for ID regulation will apply from the commencement of disclosure year 2019.	1.1.2(4)(a)
IM amendments in relation to ID regulation for asset valuation, the treatment of taxation, the cost of capital, and pricing methodologies will apply in respect of the first disclosure year after the next amendment to the ID determination made after the commencement date of the IM amendments.	1.1.2(4)(b)
IM amendments in relation to matters other than cost allocation for DPP regulation will apply for DPPs in force from 1 October 2017. <sup>174</sup> Compliance with the current DPP will apply the pre-review IMs (even after 1 October 2017, in respect of compliance requirements in the current DPP).	1.1.2(4)(c)(i), 1.1.2(4)(e)
IM amendments in relation to cost allocation for DPP regulation will apply for DPPs in force from 1 October 2022.	1.1.2(4)(d)
IM amendments in relation to CPP regulation will apply for CPP proposals submitted to us after the commencement date of the IM amendments determination.	1.1.2(4)(c)(ii), 1.1.2(4)(f)
IM amendments relating to forecast values or to matters required to be carried out by a supplier or the Commission for a DPP that will be in force from 1 October 2017 will apply from the commencement date of the IM amendments determination.	1.1.2(5)
IM amendments for cost allocation in relation to forecast values or matters required to be carried out by a supplier or the Commission in respect of a DPP to be determined after the commencement date will apply from the commencement date of the IM amendments determination.	1.1.2(6)

<sup>174</sup> To give practical effect as soon as possible to the IM amendments on the TCSD mechanism, the GDB DPP IMs allow the TCSD changes to apply for DPPs in force from 1 October 2017.

**Table E3: Timing and transition in IM amendments determination for GTBs**

Explanation of timing and transitional provisions	Clause reference in amendments determination
IM amendments in relation to cost allocation for ID regulation will apply from the commencement of disclosure year 2019.	1.1.2(4)(a)
IM amendments in relation to ID regulation for asset valuation, the treatment of taxation, the cost of capital, and pricing methodologies will apply in respect of the first disclosure year after the next amendment to the ID determination made after the commencement date of the IM amendments.	1.1.2(4)(b)
IM amendments in relation to matters other than cost allocation for DPP regulation apply for DPPs in force from 1 October 2017. <sup>175</sup> Compliance with the current DPP will apply the pre-review IMs (even after 1 October 2017, in respect of compliance requirements in the current DPP).	1.1.2(4)(c)(i), 1.1.2(4)(e)
IM amendments in relation to cost allocation for DPP regulation will apply for DPPs in force from 1 October 2022.	1.1.2(4)(d)
IM amendments in relation to CPP regulation will apply for CPP proposals submitted to us after the commencement date of the IM amendments determination.	1.1.2(4)(c)(ii), 1.1.2(4)(f)
IM amendments relating to forecast values or to matters required to be carried out by a supplier or the Commission for a DPP that will be in force from 1 October 2017 will apply from the commencement date of the IM amendments determination.	1.1.2(5)
IM amendments for cost allocation in relation to forecast values or matters required to be carried out by a supplier or the Commission in respect of a DPP to be determined after the commencement date will apply from the commencement date of the IM amendments determination.	1.1.2(6)

<sup>175</sup> To give practical effect as soon as possible to the IM amendments on the TCSD mechanism, the GTB DPP IMs allow the TCSD changes to apply for DPPs in force from 1 October 2017.

**Table E4: Timing and transition in IM amendments determination for Transpower**

Explanation of timing and transitional provisions	Clause reference in amendments determination
IM amendments will first apply in relation to ID regulation in respect of the first disclosure year after the next amendment to the ID determination made after the commencement date of the IM amendments.	1.1.2(3)(a)
IM amendments in relation to IPP regulation will apply for the IPP in force from 1 April 2020. Compliance with the current IPP will apply the pre-review IMs (even after 1 April 2020 in respect of compliance requirements in the current IPP).	1.1.2(3)(b)
IM amendments relating to forecast values or matters required to be carried out by Transpower or the Commission for the IPP in force from 1 April 2020 will apply from the commencement date of the IM amendments determination.	1.1.2(4)

**Table E5: Timing and transition in IM amendments determination for airports**

Explanation of timing and transitional provisions	Clause reference in amendments determination
Amendments in relation to ID regulation will apply from the date the IM and ID amendments determinations come into force (ie, take effect for the Commission and airports).	1.2(2)