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Electricity Distribution Services (Incremental Rolling Incentive Scheme) Input Methodology Amendments Determination 2015

[2015] NZCC 32

Input methodology amendments made under s52X of the Commerce Act 1986 to the input methodologies applicable to electricity distribution businesses contained in Decision [2012] NZCC 26.

Date of determination: 25 November 2015

The Commission: Dr M Berry
S Begg
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Commerce Commission

Wellington, New Zealand

Electricity Distribution Services (Incremental Rolling Incentive Scheme) Input Methodology Amendments Determination 2015

Pursuant to Part 4 of the Commerce Act 1986 (the Act) the Commerce Commission makes the following determination:

1. DETERMINATION AMENDED

This determination amends the *Electricity Distribution Services Input Methodologies Determination 2012* [2012] NZCC 26 (the **EDB IM Determination**).

2. COMMENCEMENT

This determination comes into force on the date on which notice of the determination is given in the New Zealand Gazette under section 52W of the Commerce Act 1986.

3. INTERPRETATION

3.1 Terms in bold type that are defined in the **EDB IM Determination** have the meaning given to those terms in the **EDB IM Determination**.

3.2 Terms in bold type used in this determination that are defined in the Act, but not this determination, have the same meaning as in the Act.

4. EDB IM AMENDMENTS

4.1 In the **EDB IM Determination**, amend clause 1.1.4(2) by:

(a) in the definition of "adjustment to the opex incentive", replacing "clause 3.3.4(2)" with "clause 3.3.4";

(b) in the definition of "capex incentive amount", replacing "clause 3.3.7(2)" with "clause 3.3.10(2)"; and

(c) inserting the following definition:

"**starting price year**, in relation to an **EDB**, means –

(a) the first **disclosure year** of a **regulatory period** (other than a **quality standard variation CPP regulatory period**) applicable to the **EDB**, and

(b) the **disclosure year** immediately following the expiration of a **CPP** (other than a **quality standard variation CPP**) applicable to the **EDB**;".

4.2 In the **EDB IM Determination**, amend clause 3.1.3(1)(a)(ii) by replacing the reference to "clause 3.3.12(2)" with "clause 3.3.15(2)".

4.3 In the **EDB IM Determination**, replace Subpart 3 of Part 3 with the following:

"SUBPART 3 **Incremental rolling incentive scheme**

SECTION 1 Annual IRIS incentive adjustments

3.3.1 Calculation of annual IRIS incentive adjustment as recoverable cost

(1) A **non-exempt EDB** must calculate an **IRIS incentive adjustment** for each **disclosure year** of each **regulatory period**.

(2) The 'IRIS incentive adjustment' is the amount determined in accordance with the formula–

opex incentive amount + **capex incentive amount**.

SECTION 2 Operating expenditure incentives

3.3.2 How to calculate opex incentive amounts

(1) An **opex incentive amount** must be calculated for each **disclosure year** of a **regulatory period**, subject to subclause (3).

(2) The 'opex incentive amount' for a **disclosure year** is an amount equal to the sum of–

(a) all **amounts carried forward** into that **disclosure year** from a **disclosure year** in a preceding **regulatory period**; and

(b) where applicable under clause 3.3.4(1), an **adjustment to the opex incentive** for that **disclosure year**.

(3) An **opex incentive amount** shall not be calculated:

(a) by Orion New Zealand Limited, for any **disclosure year** in a **regulatory period** commencing on, or prior to, 1 April 2020; and

(b) by any other **EDB**, for any **disclosure year** commencing prior to 1 April 2020, unless the **EDB** becomes subject to a **CPP** (other than a **quality standard variation CPP**).

3.3.3 How to calculate the amount carried forward to subsequent disclosure years

(1) An 'amount carried forward' must be calculated for each **disclosure year** of a **regulatory period**, subject to subclause (6).

(2) The 'amount carried forward' for the first **disclosure year** of a **regulatory period**, including the first **disclosure year** following expiration of a **CPP** (other than a **quality standard variation CPP**) applicable to the **EDB**, subject to subclause (5), is calculated in accordance with the formula–

forecast opex$_t$ – **actual opex**$_t$

where–

t means **the disclosure year** in question.

(3) The 'amount carried forward' for a **disclosure year** that is not the first or last **disclosure year** of a **regulatory period** is calculated in accordance with the formula–

(**forecast opex**$_t$ – **actual opex**$_t$) – (**forecast opex**$_{t-1}$ – **actual opex**$_{t-1}$)

where–

t means the **disclosure year** in question; and

t-1 means the **disclosure year** preceding the **disclosure year** in question.

(4) The 'amount carried forward' for the last **disclosure year** of a **regulatory period** (other than a **quality standard variation CPP regulatory period**) is nil.

(5) Where an **EDB** is subject to a **DPP determination** for no more than one consecutive **disclosure year** of the **DPP regulatory period**, the 'amount carried forward' for that **disclosure year** is nil.

(6) An **amount carried forward** shall not be calculated:

(a) by Orion New Zealand Limited, for any **disclosure year** commencing prior to 1 April 2019; and

(b) by any other **EDB**, for any **disclosure year** commencing prior to 27 November 2014.

(7) Each **amount carried forward** is notionally carried forward from the **disclosure year** in respect of which it is calculated into each of the subsequent 5 **disclosure years**.

(8) 'Forecast opex', subject to clauses 3.3.13 and 3.3.14, is, for a **disclosure year** –

(a) in a **DPP regulatory period** applying to an **EDB** for which starting prices applicable to the **EDB** were determined by the **Commission** under s 53P(3)(b) or s 53X(2), the amount of forecast **operating expenditure** specified by the **Commission** for the relevant **disclosure year** in the **DPP determination** for the purpose of calculating an **opex incentive amount**;

(b) in a **DPP regulatory period** applying to an **EDB** for which the prices applicable to the **EDB** were the prices that applied at the end of the preceding **DPP regulatory period** or **CPP regulatory period**, the amount of forecast **operating expenditure** specified by the **Commission** in the **DPP determination** or otherwise notified to the **EDB** by the **Commission**; or

(c) in a **CPP regulatory period** (other than a **quality standard variation CPP regulatory period**) applying to an **EDB**, the amount of **forecast**

operating expenditure specified by the **Commission** for the relevant **disclosure year** in accordance with clause 5.3.2(6)(b).

(9) 'Actual opex' is the amount of **operating costs** allocated to **electricity distribution services** for the relevant **disclosure year** calculated in accordance with Part 2.

3.3.4 How to calculate the adjustment to the opex incentive for the second year of a regulatory period

(1) An **adjustment to the opex incentive** must be calculated in the **disclosure year** immediately following a **starting price year**, unless the **disclosure year** in question is also a **starting price year**.

Standard case DPP

(2) For an **EDB** subject to the **DPP**, unless subclause (4) applies, the 'adjustment to the opex incentive', where the starting prices for the current **DPP regulatory period** are–

(a) determined by the **Commission** in accordance with s 53P(3)(b) of the **Act**, is an amount equal to the 'base year adjustment term' calculated in accordance with clause 3.3.5; and

(b) the prices that applied at the end of the preceding **DPP regulatory period** or **CPP regulatory period**, is an amount calculated in accordance with the formula–

base year adjustment term + *roll-over adjustment term*

where–

base year adjustment term means the amount calculated in accordance with clause 3.3.5; and

roll-over adjustment term means the amount calculated in accordance with clause 3.3.6.

Standard case CPP

(3) The 'adjustment to the opex incentive' for an **EDB** subject to a **CPP** (other than a **quality standard variation CPP**), unless subclauses (5) or (6) applies, is calculated in accordance with the formula–

base year adjustment term + *baseline adjustment term*

where–

base year adjustment term means the amount calculated in accordance with clause 3.3.5;

baseline adjustment term means the amount calculated in accordance with clause 3.3.7(1).

Special case of a DPP following a single starting price year

(4) The 'adjustment to the opex incentive' for an **EDB** subject to the **DPP**, when the **disclosure year** immediately preceding the current **regulatory period** was a **starting price year**, is calculated in accordance with the formula–

base year adjustment term + roll-over adjustment term + one-year adjustment term 1 + one-year adjustment term 2 + one-year adjustment term 3

where–

base year adjustment term means the amount calculated in accordance with clause 3.3.5;

roll-over adjustment term means the amount calculated in accordance with clause 3.3.6;

one-year adjustment term 1 means the amount calculated in accordance with clause 3.3.8(1);

one-year adjustment term 2 means the amount calculated in accordance with clause 3.3.8(2); and

one-year adjustment term 3 means the amount calculated in accordance with clause 3.3.8(3).

Special case of a CPP following a single starting price year

(5) Unless subclause (6) applies, the 'adjustment to the opex incentive' for an **EDB** subject to a **CPP** (other than a **quality standard variation CPP**), when the **disclosure year** immediately preceding the current **regulatory period** was a **starting price year**, is calculated in accordance with the formula–

base year adjustment term + baseline adjustment term + one-year adjustment term 1 + one-year adjustment term 2 + one-year adjustment term 3

where–

base year adjustment term means the amount calculated in accordance with clause 3.3.5;

baseline adjustment term means the amount calculated in accordance with clause 3.3.7(1);

one-year adjustment term 1 means the amount calculated in accordance with clause 3.3.8(1);

one-year adjustment term 2 means the amount calculated in accordance with clause 3.3.8(2); and

one-year adjustment term 3 means the amount calculated in accordance with clause 3.3.8(3).

Special case of a CPP following two consecutive starting price years

(6) The 'adjustment to the opex incentive' for an **EDB** subject to a **CPP** (other than a **quality standard variation CPP**), when the two **disclosure years** immediately preceding the current **regulatory period** were each a **starting price year**, is calculated in accordance with the formula–

baseline adjustment term + *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*

where–

baseline adjustment term means the amount calculated in accordance with clause 3.3.7(2);

one-year adjustment term 4 means the amount calculated in accordance with clause 3.3.9(1);

one-year adjustment term 5 means the amount calculated in accordance with clause 3.3.9(2);

one-year adjustment term 6 means the amount calculated in accordance with clause 3.3.9(3);

one-year adjustment term 7 means the amount calculated in accordance with clause 3.3.9(4);

one-year adjustment term 8 means the amount calculated in accordance with clause 3.3.9(5); and

one-year adjustment term 9 means the amount calculated in accordance with clause 3.3.9(6).

3.3.5 How to calculate the base year adjustment term

A 'base year adjustment term' is calculated in accordance with the formula–

$$-\left(\frac{(\mathbf{forecast\ opex}_{t-1} - \mathbf{actual\ opex}_{t-1}) - (\mathbf{forecast\ opex}_{t-2} - \mathbf{actual\ opex}_{t-2})}{(1+WACC)^4}\right)$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP** or **DPP**

t-1 means the **disclosure year** immediately prior to the current **regulatory period**; and

t-2 means the **disclosure year** commencing two years prior to the current **regulatory period**.

3.3.6 How to calculate the roll-over adjustment term

A 'roll-over adjustment term' is calculated in accordance with the formula–

(**actual opex**$_{t-2}$ – **forecast opex**$_{t}$)

×

((1-(1+*WACC*)$^{-6}$)/*WACC)*

×

(1+*WACC*)^{2}

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **DPP**;

t means the first **disclosure year** of the current **regulatory period**; and

t-2 means the **disclosure year** commencing two years prior to the current **regulatory period**.

3.3.7 How to calculate the baseline adjustment term applicable to CPP regulatory periods

(1) For the purposes of subclause 3.3.4(3) and 3.3.4(5), 'baseline adjustment term' is calculated in accordance with the formula–

– (**forecast opex**$_{t-2}$ – **actual opex**$_{t-2}$)

×

((1-(1+*WACC*)$^{-6}$)/*WACC)*

×

(1+*WACC*)^{2}

where–

t-2 means the **disclosure year** commencing two years prior to the current **regulatory period**;

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP regulatory period**.

(2) For the purposes of subclause 3.3.4(6), a 'baseline adjustment term' is calculated in accordance with the formula–

$$-(\textbf{forecast opex}_{t-4} - \textbf{actual opex}_{t-2}) \times ((1-(1+WACC)^{-6})/WACC) \times (1+WACC)^{2}$$

where–

t-2 means the **disclosure year** commencing two years prior to the current **regulatory period**;

t-4 means the **disclosure year** commencing four years prior to the current **regulatory period**; and

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP regulatory period**.

3.3.8 How to calculate adjustment terms applicable to regulatory periods preceded by a single starting price year

(1) A 'one-year adjustment term 1' is calculated in accordance with the formula–

$$(\textbf{actual opex}_{t-4} - \textbf{forecast opex}_{t-2}) \times (1+WACC)^{2}$$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **DPP** or **CPP**;

t-2 means the **disclosure year** commencing two years prior to the current **disclosure year**; and

t-4 means the **disclosure year** commencing four years prior to the current **disclosure year**.

(2) A 'one-year adjustment term 2' is calculated in accordance with the formula–

$$(\textbf{forecast opex}_{t-3} - \textbf{actual opex}_{t-3}) - (\textbf{forecast opex}_{t-4} - \textbf{actual opex}_{t-4}) \times$$

$((1-(1+WACC)^{-4})/WACC)$

×

$(1+WACC)^{2}$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **DPP** or **CPP**;

t-3 means the **disclosure year** commencing three years prior to the current **disclosure year**; and

t-4 means the **disclosure year** commencing four years prior to the current **disclosure year**.

(3) A 'one-year adjustment term 3' is calculated in accordance with the formula–

$(\textbf{forecast opex}_{t-2} - \textbf{forecast opex}_{t-4}) / (1+WACC)^{4}$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **DPP** or **CPP**;

t-2 means the **disclosure year** commencing two years prior to the current **disclosure year**; and

t-4 means the **disclosure year** commencing four years prior to the current **disclosure year**.

3.3.9 <u>How to calculate adjustment terms applicable to CPP regulatory periods preceded by two successive starting price years</u>

(1) A 'one-year adjustment term 4' is calculated in accordance with the formula–

$(\textbf{actual opex}_{t-5} - \textbf{forecast opex}_{t-3})$

×

$(1+WACC)^{3}$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**;

t-3 means the **disclosure year** commencing three years prior to the current **disclosure year**; and

t-5 means the **disclosure year** commencing five years prior to the current **disclosure year**.

(2) A 'one-year adjustment term 5' is calculated in accordance with the formula–

(**actual opex**$_{t-4}$ – **forecast opex**$_{t-2}$)

×

$(1+WACC)^2$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**;

t-2 means the **disclosure year** commencing two years prior to the current **disclosure year**; and

t-4 means the **disclosure year** commencing four years prior to the current **disclosure year**.

(3) A 'one-year adjustment term 6' is calculated in accordance with the formula–

(**actual opex**$_{t-5}$ – **actual opex**$_{t-4}$)

×

$((1-(1+WACC)^{-4})/WACC)$

×

$(1+WACC)^3$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**;

t-4 means the **disclosure year** commencing four years prior to the current **disclosure year**; and

t-5 means the **disclosure year** commencing five years prior to the current **disclosure year**.

(4) A 'one-year adjustment term 7' is calculated in accordance with the formula–

(**actual opex**$_{t-4}$ – **actual opex**$_{t-3}$)

×

$((1-(1+WACC)^{-4})/WACC)$

×

$(1+WACC)^2$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**;

t-3 means the **disclosure year** commencing three years prior to the current **disclosure year**; and

t-4 means the **disclosure year** commencing four years prior to the current **disclosure year**.

(5) A 'one-year adjustment term 8' is calculated in accordance with the formula–

$(\textbf{actual opex}_{t-2} - \textbf{actual opex}_{t-3}) / (1+WACC)^4$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**;

t-2 means the **disclosure year** commencing two years prior to the current **disclosure year**; and

t-3 means the **disclosure year** commencing three years prior to the current **disclosure year**.

(6) A 'one-year adjustment term 9' is calculated in accordance with the formula–

$(\textbf{forecast opex}_{t-5} - \textbf{forecast opex}_{t-4})$

×

$((1/(1+WACC))^4 + 1/(1+WACC)^2 - (1+WACC)^2)$

where–

WACC means the **WACC** as determined by the **Commission** and applicable to the **EDB**'s current **CPP**;

t-4 means the **disclosure year** commencing four years prior to the current **disclosure year**; and

t-5 means the **disclosure year** commencing five years prior to the current **disclosure year**.

SECTION 3 Capital expenditure incentives

3.3.10 How to calculate capex incentive amounts

(1) A **capex incentive amount** must be calculated for each **disclosure year** of a **DPP regulatory period** irrespective of whether the **EDB** in question is subject to a **CPP** or a **DPP** during that **DPP regulatory period**, subject to subclause (3).

(2) The 'capex incentive amount' for a **disclosure year** is–

(a) the amount calculated in accordance with the following formula for a **disclosure year** in the **DPP regulatory period** other than the first **disclosure year**–

$$\left(\frac{capex\ wash\text{-}up + retention\ adjustment}{l-1}\right) \times (1+r)^{y+0.5}$$

where–

l is the number of **disclosure years** in the **DPP regulatory period**;

r is the **cost of debt** applying to the **DPP** or **CPP** in question; and

y is the number of **disclosure years** preceding the **disclosure year** in question in the **DPP regulatory period**; and

(b) nil-

(i) for the first **disclosure year** of the **DPP regulatory period**; and

(ii) for a **disclosure year** in a **DPP regulatory period** which commences prior to 1 April 2020.

(3) A **capex incentive amount** shall not be calculated:

(a) by Orion New Zealand Limited, for any **disclosure year** in a **regulatory period** commencing on, or prior to, 1 April 2020; and

(b) by any other **EDB**, for any **disclosure year** in a **DPP regulatory period** commencing prior to 1 April 2020.

3.3.11 How to calculate the capex wash-up

(1) The 'capex wash-up' is an amount equal to the present value of the differences in the series of building block allowable revenues before tax for the preceding **DPP**

regulatory period, subject to subclause (2) and clauses 3.3.13 and 3.3.14 from adopting–

(a) the sum of the **value of commissioned assets** for each **disclosure year** of that preceding **DPP regulatory period**,

instead of–

(b) for each **disclosure year** of the preceding **DPP regulatory period** in which the **EDB** was subject to a **DPP**, the **forecast aggregate value of commissioned assets** determined by the **Commission** in respect of those **disclosure years**; and

(c) for each **disclosure year** of the preceding **DPP regulatory period** in which the **EDB** was subject to a **CPP**, the sum of the **forecast value of commissioned assets** determined by the **Commission** in respect of those **disclosure years**.

(2) For the purpose of subclause (1)–

(a) the present value must be determined by discounting the building block allowable revenues before tax to the end of the preceding **DPP regulatory period** using a discount rate equal to the **WACC** applied by the **Commission** in setting prices for each **disclosure year** for the relevant **DPP** or **CPP** in the preceding **DPP regulatory period**;

(b) the series of building block allowable revenues before tax for each **disclosure year** of the preceding **DPP regulatory period** must–

(i) be calculated using the same methodology that was applied by the **Commission** in setting starting prices for the **EDB** for the relevant **DPP** or **CPP**, subject to subparagraphs (ii) and (iii);

(ii) for the purpose of subparagraph (i), adopt the sum of **depreciation** calculated under Part 2 in respect of each **disclosure year** for assets having a **commissioning date** in the preceding **DPP regulatory period**; and

(iii) for the purpose of subparagraph (i), adopt the same values for all other inputs to the calculation of building block allowable revenues before tax; and

(c) where building block allowable revenues before tax from adopting the sum of **value of commissioned assets** exceed the building block allowable revenues before tax from using the forecast values of commissioned assets (as determined using the **forecast aggregate value of commissioned assets** for each **disclosure year** in which the **EDB** was subject to a **DPP** and sum of the **forecast value of commissioned assets** for each **disclosure year** in which the **EDB** was

subject to a **CPP** (other than a **quality standard variation CPP**)) then the difference is a positive amount of capex wash-up; and

(d) where building block allowable revenues before tax from adopting the sum of **value of commissioned assets** is less than the building block allowable revenues before tax from using the forecast value of commissioned assets (as determined using the **forecast aggregate value of commissioned assets** for each **disclosure year** in which the **EDB** was subject to a **DPP** and sum of the **forecast value of commissioned assets** for each **disclosure year** in which the **EDB** was subject to a **CPP** (other than a **quality standard variation CPP**)) then the difference is a negative amount of capex wash-up.

3.3.12 How to calculate the retention adjustment

(1) The 'retention adjustment' is calculated in accordance with the formula–

(PV of forecast commissioned asset values – PV of actual commissioned asset values) x **retention factor**.

(2) 'PV of forecast commissioned asset values' is an amount equal to the sum of–

(a) the present value, as at the end of the preceding **DPP regulatory period**, of the **forecast aggregate value of commissioned assets** for each **disclosure year** of the preceding **DPP regulatory period** for which the **EDB** was subject to a **DPP**; and

(b) the present value, as at the end of the preceding **DPP regulatory period**, of the sum of the **forecast value of commissioned assets** for each **disclosure year** of the preceding **DPP regulatory period** for which the **EDB** was subject to a **CPP**.

(3) 'PV of actual commissioned asset values' is the present value, as at the end of the preceding **DPP regulatory period**, of the **value of commissioned asset** calculated in accordance with Part 2 for every asset that was **commissioned** during the preceding **DPP regulatory period**.

SECTION 4 Price-quality path amendments and other events

3.3.13 Calculating alternative incentive adjustments following price-quality path transitions

(1) Where a price-quality path is amended following–

(a) a **catastrophic event**;

(b) a **change event**;

(c) an **error**; or

(d) provision of false or misleading information under clause 4.5.4(1)(e) or 5.6.4(4),

the **forecast opex** and **forecast aggregate value of commissioned assets** required to be used by the **EDB** to calculate the **amount carried forward** for the **disclosure year** in which the event occurred and each subsequent **disclosure year** prior to the effective date of the amendment to the price-quality path, is the amount specified by the **Commission** in the amended **DPP determination** or amended **CPP determination**.

(2) An **EDB** subject to a **CPP** (other than a **quality standard variation CPP**) must calculate the **amount carried forward** for each **disclosure year** of the preceding **DPP regulatory period** applicable to the **EDB** using any alternative **forecast opex** and **forecast aggregate value of commissioned assets** specified by the **Commission** in the **CPP determination**.

(3) Following expiration of a **CPP** (other than a **quality standard variation CPP**) applicable to the **EDB**, the **EDB** must calculate the **amount carried forward** for each remaining **disclosure year** of the current **DPP regulatory period** using any **forecast opex** and **forecast aggregate value of commissioned assets** notified by the **Commission**, unless the **EDB** becomes subject to a new **CPP**.

3.3.14 Calculating incentive adjustments for other events

Where an event that is–

(a) an **amalgamation**;
(b) a merger (as defined in a **DPP determination**);
(c) a major transaction (as defined in a **DPP determination**); or
(d) an alteration to Part 2 or **ID determination** requirements affecting the quantification of **operating costs** allocated to electricity distribution services or a **value of commissioned asset**,

occurs in a **disclosure year** and–

(e) the **Commission** considers; or
(f) the **EDB** in question satisfies the **Commission** upon application,

that the event has, or is likely to have, a material effect on the calculation of the **opex incentive amount** or **capex incentive amount** that would otherwise have been required to be calculated by the **EDB** then–

(g) the **forecast opex**; and
(h) either–

(i) **forecast aggregate value of commissioned assets**; or
(ii) sum of the **forecast value of commissioned assets**,

required to be used by the **EDB** to calculate the **amount carried forward** for that **disclosure year** and each subsequent **disclosure year** in the **regulatory period** may

be determined by the **Commission**, and notified to the **EDB**, in order to preserve, to the extent appropriate–

(i) the correct outcomes for expenditure efficiencies achieved before the event; and

(j) the relevant incentive properties after the event.

SECTION 5 Transitional provisions

3.3.15 Calculation of annual incremental changes and adjustment term

(1) The incremental change for the first **disclosure year** of a **CPP regulatory period** commencing prior to 27 November 2014 is determined as the difference between **allowed controllable opex** and **actual controllable opex.**

(2) The incremental change for a **disclosure year** of a **CPP regulatory period** commencing prior to 27 November 2014 other than the **first** or final **disclosure year** must be determined in accordance with the formula-

(**allowed controllable opex**$_t$ - **actual controllable opex**$_t$) - (**allowed controllable opex**$_{t-1}$ - **actual controllable opex**$_{t-1}$),

where-

t means the **disclosure year** in question; and

t-1 means the **disclosure year** preceding the **disclosure year** in question.

(3) The incremental change for the final **disclosure year** of the **CPP regulatory period** commencing prior to 27 November 2014 is treated as nil.

(4) The incremental adjustment term is determined-

(a) in the next **disclosure year** following a **CPP regulatory period** commencing prior to 27 November 2014; and

(b) by applying the **inflation rate** to the result of the formula-

(**allowed controllable opex**$_{t-1}$ - **actual controllable opex**$_{t-1}$) - (**allowed controllable opex** $_{t-2}$ - **actual controllable opex** $_{t-2}$)

where-

t-1 means the final **disclosure year** of the preceding **CPP regulatory period** commencing prior to 27 November 2014; and

t-2 means the penultimate **disclosure year** of the preceding **CPP regulatory period** commencing prior to 27 November 2014.

(5) Inflation rate means the amount determined in accordance with the formula-

$$[(CPI_1 + CPI_2 + CPI_3 + CPI_4) \div (CPI_1^{-4} + CPI_2^{-4} + CPI_3^{-4} + CPI_4^{-4})] - 1,$$

where-

CPI_n means **forecast CPI** for the nth quarter of the **disclosure year** in question; and

CPI_n^{-4} means **forecast CPI** for the equivalent quarter in the preceding **disclosure year**.

3.3.16 Determination of amount to be taken into account as a recoverable cost

(1) Each incremental change determined in accordance with clause 3.3.15 and **incremental adjustment term** is notionally carried forward, subject to clause 3.3.17, from the **disclosure year** in respect of which it is determined into each of the subsequent 5 **disclosure years** by applying the **inflation rate**.

(2) In each of the **disclosure years** after a **CPP regulatory period in**to which an amount has been carried pursuant to subclause (1), a net balance must be determined by addition of-

(a) any incremental changes carried into that **disclosure year** from a preceding **CPP regulatory period**; and

(b) any **incremental adjustment term** carried into that **disclosure year**.

3.3.17 Calculating gains and losses after a catastrophic event

Where-

(a) a price-quality path is amended pursuant to clause 5.6.5 by reason of a **catastrophic event**; and

(b) incremental changes calculated in the remaining **disclosure years** of the **regulatory period** in accordance with clauses 3.3.15(1) and 3.3.15(2) are negative,

clause 3.3.16(1) does not apply to those incremental changes."

Sue Begg, *Deputy Chair*

Dated at Wellington this 25th day of November 2015.

COMMERCE COMMISSION