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Reconsideration of Transpower's individual price-quality path determination in response to the Electricity Authority decisions on Transmission Pricing Methodology

Changes to expenditure allowances for the costs of TPM development and implementation in the 2023 to 2025 disclosure years

Final decision

Date of publication: 12 October 2023

Contents

Chapter 1 Introduction and summary of our decision

1.1 This paper sets out our decision on how we will treat Transpower's costs for remaining years of the 2020-2025 Regulatory Control Period (**RCP3**) for implementing the new Transmission Pricing Methodology (**TPM**), which will determine ultimately how much of those costs can be passed on to consumers.

Introduction

1.2 This decision is our third reconsideration of the *Transpower Individual Price-Quality Path Determination 2020* [2019] NZCC 19 (**Transpower's IPP**) to account for TPM expenditure. Our decisions to reconsider Transpower's IPP result from correspondence from the Electricity Authority under section 54V(3) and (5) of the Commerce Act (the **Act**) (the **Authority**) notifying us of relevant changes to the Code and requesting we reconsider Transpower's IPP.[1]

Summary of our decisions

1.3 Our decision is to reconsider Transpower's IPP to allow Transpower to recover its:

1.3.1 actual costs incurred to implement the TPM for 1 July 2022 to 30 June 2023 (**DY23**); and

1.3.2 forecast costs required to implement the TPM in 1 July 2023 to 30 June 2024 (**DY24**) and 1 July 2024 to 30 June 2025 (**DY25**). The costs allowed are as follows:

Category of expenditure	DY23	DY24	DY25	Total
Opex	$4.3 million	$4.4 million	$3.9 million	
Capex	$2.1 million	$1.9 million	$1.9 million	
Total	**$6.4 million**	**$6.3 million**	**$5.8 million**	**$18.5 million**

1.4 Our decision is to amend Transpower's price path through the wash-up building blocks and EV account wash-up mechanism rather than reopen the MAR and SMAR. We consider using the wash-up mechanisms as a pragmatic approach which reduces regulatory complexity, proportionate to the materiality of our amendments.

1 Electricity Authority to Chief Executive of the Commerce Commission, *Development of a proposed new transmission pricing methodology*, 10 June 2020; Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022.

Chapter 2 Background and basis for our decision

2.1 This chapter sets out:

2.1.1 the statutory framework for reconsidering and amending Transpower's IPP determination following the Authority's advice of its decisions on the 2020 TPM guidelines and the incorporation of the new TPM into the Code; and

2.1.2 the background to our 2023 decision, including our November 2022 reconsideration decision on Transpower's costs to develop and implement the TPM.

Statutory framework for reconsidering and amending the IPP following the Authority's advice of its decisions and reconsideration requests

2.2 We are required to determine Transpower's individual price-quality path under Part 4 of the Commerce Act 1986 (the **Act**). An individual price-quality path is determined on an *ex-ante* basis and applies for a regulatory period of five years,[2] although we may set a shorter period than five years if we consider doing so would better meet the purpose of Part 4 under section 52A of the Act.[3]

2.3 We set out Transpower's individual price-quality path in a determination we make under section 52P of the Act. Once determined, Transpower's individual price-quality path may not be reconsidered or reopened within a regulatory period except in limited circumstances. One of those circumstances is where the Authority has asked us to reconsider a section 52P determination under section 54V(5) of the Act. Under section 54V(2) of the Act, the Authority must advise us where it makes a provision of the Code, or a decision under the Code, that is likely to be relevant to the Commission's functions. Section 54V(4) requires us to then take these matters into account when reconsidering a section 52P determination.

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[2] Commerce Act 1986, section 53ZC(2)(a) and 53M(4).

[3] Commerce Act 1986, section 53ZC(2)(a) and 53M(5).

2.4 The Authority has made two such requests that are relevant to Transpower's individual price quality path determination for the regulatory period from 1 April 2020.[4] Upon receipt of such a request, section 54V(5) requires that the Commission must reconsider and, "to the extent that the Commission considers it necessary or desirable to do so", amend the individual price-quality path determination to take account of the relevant matters. Matters identified by the Authority at the time of making its requests were its decisions under, and in relation to, the Code relating to the pricing methodology applicable to Transpower and the impact of those decisions on Transpower's costs over the regulatory period.

2.5 We consider that we have a discretion to take a staged approach to reconsidering and amending a section 52P determination under section 54V, where we consider this to be necessary and desirable to best give effect to the section 52A purpose.

2.6 Under section 52Q of the Act, we may only amend a section 52P determination in a material way after we have consulted with interested parties.

Background to the IPP determination

2.7 On 29 August 2019, we published a paper that set out our decisions and supporting reasons for setting Transpower's individual price-quality path for the five-year regulatory period from 1 April 2020 (**Reasons paper**).[5] Transpower's individual price-quality path, which we determine under Part 4 of the Act, sets the maximum revenues that Transpower may recover from its customers for its electricity transmission services, as well as the minimum quality standards it must meet for those services, for each year of the regulatory period.

2.8 On 14 November 2019, we determined the Transpower IPP determination under section 52P of the Act, which sets out Transpower's individual price-quality path for the regulatory period from 1 April 2020 to 31 March 2025. This is Transpower's third individual price-quality path, and the regulatory control period is referred to as "RCP3".[6]

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[4] Electricity Authority to Chief Executive of the Commerce Commission, *Development of a proposed new transmission pricing methodology*, 10 June 2020; Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022, para 3.

[5] Commerce Commission, *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019

[6] Commerce Commission, *Transpower Individual Price-Quality Path Determination 2020* [2019] NZCC 19.

Our decisions on operating expenditure and capital expenditure allowances for TPM development

2.9 In the IPP Reasons paper we noted:[7]

> Our expenditure decisions do not include any opex allowance or approved base capex for further development of the TPM because the development, timing and amount of expenditure necessary to make that development happen is still not sufficiently certain. The Electricity Authority has published a consultation paper on the TPM,[41] and it appears likely that Transpower will need to respond to finalisation of updated TPM guidelines at some time during RCP3 by making changes to the TPM.[42] An adjustment to the expenditure allowances may be required during the regulatory period to accommodate this at the request of the Electricity Authority, which is permitted under the Act.[43]
>
> [footnotes omitted]

Our RCP3 decision on the wash-up calculation

2.10 In the IPP Reasons paper, we explained our decision for Transpower's forecast maximum allowable revenue (**MAR**) to be calculated using a building blocks approach with a MAR wash-up.[8] The wash-up would correct for any over or under recovery of revenue by Transpower.[9]

2.11 This wash-up mechanism is implemented in the Transpower IPP determination in the following way:[10]

2.11.1 clause 9 requires Transpower to annually calculate a wash-up in accordance with clause 29;

2.11.2 clause 29 sets out the various inputs that Transpower must use in calculating the wash-up. Clause 29.1.1 requires Transpower to use the approach and formulae specified in Schedule E; and

2.11.3 Schedule E sets out each 'building block' of the wash-up calculation.

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7 Commerce Commission, *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, at X44.

8 Commerce Commission, *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, at X45.2.

9 Commerce Commission, *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, at X45.5.

10 Commerce Commission, *Transpower Individual Price-Quality Path Determination 2020* [2019] NZCC 19 (as amended).

2.12 Formula H of Schedule E specifies the 'Transmission revenues received' wash-up building block of the wash-up calculation. This building block is defined as being the 'actual transmission revenue'. Similarly, formula K of Schedule E specifies that 'other regulated income' is a wash-up building block of the wash-up calculation.

2.13 Clause 7 of the Transpower IPP determination currently defines "actual transmission revenue" to mean:

> the revenue received by Transpower in a pricing year for electricity transmission services…;

2.14 Clause 7 of the Transpower IPP determination currently defines "other regulated income" to mean:

> income associated with the supply of electricity transmission services, excluding actual transmission revenue and investment-related income;

Our previous decisions to reconsider Transpower's IPP to account for TPM expenditure

2.15 In 2020, the Authority requested that we reconsider Transpower's IPP under section 54V(5) of the Act.[11] The Authority made these requests at the same time as notifying us that it had issued guidelines that were likely to be relevant to the exercise of our powers or performance of our duties or functions under Part 4 of the Act.

2.16 The 2020 TPM guidelines and accompanying reasons paper set out requirements for a proposed new TPM, together with the Authority's decision on process and timeframe for development and implementation of the TPM. The process and timeframe included Transpower submitting a proposed TPM meeting the guidelines requirements by 31 June 2021 followed by a review phase of the Electricity Industry Participation Code 2010 (the **Code**) which, in turn, would be followed by a number of implementation phases leading to the publication of new prices to commence 1 April 2023. The timeline assumed some overlap in the commencement of the different phases.

[11] Electricity Authority, *Transmission pricing methodology 2020 Guidelines and process for development of a proposed TPM - Decision*, 10 June 2020.

2.17 The Authority's notification advised that it required Transpower to develop a new TPM. The Authority further advised us that it considered there would be increased costs to Transpower to develop and, if the Authority were to decide to include it in the Code, implement a new TPM.[12] The Authority considered these costs were likely to be more than *de minimis*.

2.18 In October 2021, we reconsidered the Transpower IPP and concluded that it would be desirable to amend the Transpower IPP to take account of Transpower's expenditure to develop and implement the new TPM in more than one stage.[13] A key consideration for the timing and number of reopeners would be the extent to which we could reach appropriate levels of confidence in Transpower's TPM expenditure and forecasts. We decided to amend the IPP at that time to account for costs incurred by Transpower in development of the TPM for the 2020-21 disclosure year (**DY21**).[14]

2.19 In April 2022, the Authority notified the Commission that it had incorporated the new TPM into the Code, that Transpower was required to implement the new TPM with a commencement date of 1 April 2023, and that this was likely to be relevant to our powers or functions under Part 4 of the Act.[15] The Authority advised that this Code change would result in increased costs to Transpower,[16] and requested that we consider amending the Transpower IPP determination under section 54V(5).[17]

2.20 We considered that the Authority's two notifications and reopener requests together encompass the whole of Transpower's costs in relation to development and implementation of the TPM incorporated into the Code in April 2022, commencing from the Authority's issue of the 2020 TPM guidelines.

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[12] Electricity Authority to Chief Executive of the Commerce Commission, *Development of a proposed new transmission pricing methodology*, 10 June 2020, paras 4 and 5.

[13] Commerce Commission, *Reconsideration of Transpower's individual price-quality path determination in response to the Electricity Authority decision on Transmission Pricing Methodology guidelines – changes to 2020-21 expenditure allowances for the costs of TPM development – Final reasons*, 7 October 2021, para 9.

[14] Commerce Commission, *Reconsideration of Transpower's individual price-quality path determination in response to the Electricity Authority decision on Transmission Pricing Methodology guidelines – changes to 2020-21 expenditure allowances for the costs of TPM development – Final reasons*, 7 October 2021.

[15] Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022, para 3.

[16] Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022, para 3.

[17] Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022, para 5.

2.21 In December 2022, we decided to reconsider and amend Transpower's IPP to allow Transpower to recover its actual expenditure on developing and implementing the new TPM for the 2021-2022 disclosure year (**DY22**). At the time of that decision, we anticipated a further reopener would likely be necessary for the period from DY23 onwards.[18]

Our decisions to amend Transpower's IPP determination in stages

2.22 In April 2022, as detailed above, we received a subsequent request from the Authority to reconsider the Transpower IPP determination under section 54V(5) of the Act.[19]

2.23 Our view in that decision was that under section 54V(5) of the Act, it was desirable to amend the Transpower IPP determination in stages to take account of Transpower's expenditure in developing and implementing the new TPM. This was because, at the time of decision, we only had sufficient certainty and clarity to make amendments to the Transpower IPP determination that related to Transpower's TPM development and implementation expenditure for DY22.

2.24 Accordingly, we decided in 2021 that the Transpower IPP determination would be amended in stages in respect of adjustments for the TPM. We noted in 2022 that we would likely amend the IPP one more time in 2023 to amend the IPP on an *ex-post* basis for costs incurred in DY23 and on an *ex-ante* basis for forecast costs in the remaining years of RCP3 (ie, DY24 and DY25) when Transpower is able to provide us with sufficient information to give us confidence that its forecast expenditure was credible. This would provide Transpower with an incentive to complete the remaining stages of the TPM efficiently.

Electricity Authority notifications and reopener requests – scope of expenditure

2.25 The 2020 notification and reopener request from the Authority requested that we reconsider Transpower's IPP to allow Transpower to recover costs for developing the TPM.[20]

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[18] Commerce Commission, *Reconsideration of Transpower's individual price-quality path determination in response to the Electricity Authority decision on Transmission Pricing Methodology guidelines – changes to 2020-21 expenditure allowances for the costs of TPM development – Final reasons*, 7 October 2021, para 35.

[19] Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022, para 3.

[20] Electricity Authority, *Transmission pricing methodology 2020 Guidelines and process for development of a proposed TPM - Decision*, 10 June 2020.

2.26 The 2022 notification and reopener request from the Authority requested that we reopen Transpower's IPP to allow Transpower to recover costs of implementing the TPM.[21]

2.27 In our 2022 TPM reconsideration decision, we considered that the Authority's 2020 and 2022 notifications and reopener requests together encompass the whole of Transpower's costs in relation to development and implementation of the TPM.[22]

2.28 The Authority's notifications and requests, together with our decision to amend the IPP in stages, provide the basis for the current reconsideration application to allow Transpower to recover costs associated with developing and implementing the new TPM.

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21 Electricity Authority to Chief Executive of the Commerce Commission, *A new Transmission Pricing Methodology*, 12 April 2022.

22 Commerce Commission, *Reconsideration of Transpower's individual price-quality path determination in response to the Electricity Authority decisions on Transmission Pricing Methodology - Changes to 2021-22 expenditure allowances for the costs of TPM development and implementation: Final Decision*, 22 November 2022, para 7.

Chapter 3 Our assessment of Transpower's TPM expenditure and our amendments to Transpower's IPP determination

3.1 This chapter sets out:

3.1.1 a summary of the information Transpower provided us in support of our reconsideration of Transpower's IPP for the remaining years of RCP3;

3.1.2 our decision; and

3.1.3 our reasons for our decision to amend the Transpower IPP determination allowing Transpower to recover its actual expenditure on the implementation of the new TPM for DY23 and forecasted expenditure for DY24 and DY25.

Information provided by Transpower for its 2023 application

3.2 In its letter dated 19 May 2023, Transpower provided us with information to enable us to evaluate the expenditure that it has incurred in DY23 and forecasted expenditure for DY24 and DY25 on the implementation of the new TPM.[23]

3.3 In its letter, Transpower provided indicative expenditure figures and a breakdown of costs by category to support its application.

3.4 Transpower engaged Deloitte to undertake an independent assurance report, for its TPM project. Transpower provided us with this report. The report provides a preliminary assessment on the expenditure on the TPM project for DY23 and forecasting practices for DY24 and DY25.

3.5 The assurance report covered aspects of the TPM project including governance, risk and issue management, cost control and assurance practices, costs and expenditure, forecasting practices, reasonableness of costs.

3.6 In relation to the costs incurred and forecast for DY22/23, Deloitte noted that:[24]

> The TPM actual expenditure appears reasonable and consistent with Transpower's obligation to develop the TPM, investigate systems, and administer the TPM to produce final pricing.

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[23] Transpower New Zealand Limited to Transpower and Gas Manager of the Commerce Commission, *Transmission Pricing Methodology (TPM) – Disclosure Years 2022/23, 2023/2024, and 2024/25 Funding Arrangements*, 19 May 2023.

[24] Transpower New Zealand Limited to Transpower and Gas Manager of the Commerce Commission, *Transmission Pricing Methodology (TPM) – Disclosure Years 2022/23, 2023/2024, and 2024/25 Funding Arrangements*, above n23, at page 4.

3.7 In relation to the forecast costs for DY24 and DY25, Deloitte noted:[25]

> For FY24 and FY25, our procedures and conclusion are limited due these years being based on forecast expenditure information. However we can corroborate that Transpower is in a position to produce forecasts for these years with a high degree of certainty, and we are satisfied the process supporting the preparation of the these forecasts appears in line with the existing cost control practices and that governance over these forecasts is expected to be maintained. Spend for FY24 and FY25 is forecast to be broadly consistent with FY23. While the amount is consistent we observed a change in the mix of expenditure, with a progressive transition to less reliance on external contractors for FY24 and FY25, more use of internal resources, declining spend on business change and programme management and more spend on core grid pricing functions. These trends are consistent with TPM progressively moving into a business-as-usual footing.

3.8 Transpower provided an updated actual expenditure incurred costs for DY23 on 13 July 2023.[26] It sets out the actual expenditure (and forecast costs) as follows:

Cost type	DY22/23	DY23/24	DY24/25
TPM programme operating expenditure	4,035,000	4,170,000	3,930,000
TPS investigation operating expenditure	269,000	200,000	-
TPS development capital expenditure	2,087,000	1,928,000	1,900,000
Total	**6,391,000**	**6,298,000**	**5,830,000**

3.9 Transpower also provided a response to a Request for Information (**RFI**), which provided further context as to the amount that is additional to the approved RCP3 price path allowance.

Our assessment of Transpower's actual expenditure for DY23

3.10 We consider it is appropriate and consistent with the s 52A purpose to allow Transpower to fully recover its actual costs for DY23, because:

3.10.1 Under the Code, Transpower is required to implement a TPM. The costs of developing and implementing the TPM in DY23, DY24 and DY25 were not already provided for in the Transpower IPP determination;[27]

25 Transpower New Zealand Limited to Transpower and Gas Manager of the Commerce Commission, *Transmission Pricing Methodology (TPM) – Disclosure Years 2022/23, 2023/2024, and 2024/25 Funding Arrangements*, above n 23, at page 4.

26 Transpower New Zealand Limited to Transpower and Gas Manager of the Commerce Commission, *Transmission Pricing Methodology (TPM) – Disclosure Years 2022/23, 2023/2024, and 2024/25 Funding Arrangements*, above n 23, at page 4.

3.10.2 Under its relevant statutory objective and purpose,[28] the Authority has concluded that there will be substantial net benefits to electricity consumers over the long term from implementing the new TPM.[29] Under s 54V(4) we are required to take into account any provision of or decision relating to the Code relevant to our functions. The Authority's assessment of consumer benefit and decision to introduce the TPM is relevant to our decision to reconsider Transpower's IPP;[30]

3.10.3 While it is not possible to provide incentives for efficient expenditure in respect of costs that have already been incurred, we consider that, given the relatively low materiality of the expenditure,[31] Deloitte's independent TPM project review gives us sufficient confidence to approve Transpower's actual opex for inclusion in the opex allowance for the price path and the 'forecast opex' amount for IRIS incentive and capex for inclusion in the incremental approved listed project base capex;

3.10.4 Approving the actual amount, which was incurred before Transpower obtained forecasts with high levels of confidence, and before it had an opportunity to apply for reconsideration of its IPP, will provide Transpower sufficient certainty that it may recover costs associated with the regulatory change; and

3.10.5 Based on Deloitte's assessment that TPM actual expenditure appears reasonable and consistent with Transpower's obligation to develop the TPM, investigate systems, and administer the TPM to produce final pricing.

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27 Under s 52A(1)(a) and (b) the Commission purpose is to promote incentives to invest in assets and provide services at a quality that reflects consumer demands. In this case, the Commission promotes the s 52A outcomes by allowing recovery of expenditure incurred due to regulatory change.

28 Sections 15 and 32(1) of the Electricity Industry Act.

29 Electricity Authority, *Transmission pricing methodology 2020 Guidelines and process for development of a proposed TPM - Decision*, 10 June 2020, page i.

30 For completeness, our decision is made under s 54V(5), applying the Part 4 purpose set out in s 52A of the Act.

31 These amendments are of relatively low materiality, with the future revenue impact being substantially lower than the 1% revenue threshold typically used as a benchmark in price path reconsideration.

3.10.5.1 We consider this shows that Transpower's expenditure is necessary to take into account the regulatory change to the Code. This promotes outcomes consistent with limiting Transpower's ability to extract excessive profits by allowing Transpower to recover costs that are not reasonable and consistent with the obligations to develop and implement the TPM.[32]

Our assessment of Transpower's forecast expenditure for DY24 and DY25

3.11 For DY24 and DY25, we consider amending Transpower's IPP on an *ex-ante* basis is consistent with s 52A(1)(c) by providing incentives for Transpower to minimise its expenditure and share those efficiency gains.

3.12 Deloitte considered that:

3.12.1 The TPM project had retained a governance structure which provided monitoring and oversight including over progress, risks and financial management. This was supported by monthly reporting. The TPM project retained a clear accountability, oversight, and monitoring model. Deloitte further concluded that it could corroborate that Transpower is in a position to produce forecasts or DY24 and DY25 with a high degree of certainty and the process supporting the forecasting appears in line with the existing cost control practices and that governance over these forecasts is expected to be maintained;[33] and

3.12.2 The TPM project has retained its cohesive project structure and effective governance model. Costs for the remaining months in FY23, FY24, FY25 are forecast based on expected resourcing levels, with these expected to remain consistent with current budgeted levels. There continues to be a strong focus on cost management and control, and project workstreams and deliverables that are transparent and traceable to statutory obligations to deliver the TPM.[34]

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[32] Consistent with s 52A(1)(d) of the Commerce Act 1986.

[33] Transpower New Zealand Limited to Transpower and Gas Manager of the Commerce Commission, *Transmission Pricing Methodology (TPM) – Disclosure Years 2022/23, 2023/2024, and 2024/25 Funding Arrangements*, above n 23, at page 4.

[34] Transpower New Zealand Limited to Transpower and Gas Manager of the Commerce Commission, *Transmission Pricing Methodology (TPM) – Disclosure Years 2022/23, 2023/2024, and 2024/25 Funding Arrangements*, above n 23, at page 4.

3.13 We issued an RFI to Transpower based on its statement that the TPM project was transitioning into a Business-as-usual (**BAU**) state. In our RFI, we asked Transpower to provide an explanation as to whether these new BAU costs were additional to the BAU costs that have been approved under the IPP for operating the old TPM, the extent of the additional costs, and drivers for the additional forecasted costs. We wanted to understand how the BAU costs of the new TPM compared to the RCP3 TPM BAU.

3.14 In its response to the RFI, Transpower provided a substantial response explaining the reasons and categories of additional costs accompanied by supporting evidence, which cannot be published or reproduced in detail due to the confidential nature of the costs. We considered that the response provided sufficient details for our assessment.

3.15 Transpower explained that the new BAU costs applied for were additional to what was approved under the IPP for BAU costs of operating the old TPM that was in effect at the start of RCP3.

3.16 We are satisfied with Transpower's explanation that there is an increase in costs for administering the new TPM at a BAU state, due to the increased complexity compared to the old TPM. This will require more resources to explain to individual customers and answer pricing queries, and to understand the new TPM to properly apply the methodologies included in the new TPM.

3.17 Further, Transpower explained that the increased legal costs are required for legal assurance from the new TPM even at a BAU state initially. We have assessed that these costs are reasonable, because Transpower will often need to seek independent legal advice on matters of TPM implementation, particularly in relation to matters of TPM interpretation, procure assurance for the modelling to implement pricing, and undertake consultation packages.

Our assessment of Transpower's information

3.18 Based on the information Transpower provided, we consider that the forecast expenditure component in Transpower's reconsideration application is:

3.18.1 consistent with the s 52A purpose;

3.18.2 reasonable;

3.18.3 forecast with sufficient confidence; and

3.18.4 additional to TPM operating costs included in Transpower's RCP3 IPP.

3.19 Following our assessment of the available information, including the Deloitte assurance report and responses to our RFI, we are satisfied that the expenditure is reasonably required to implement the new TPM and we can have a sufficient level of confidence in the forecast costs. We consider it is appropriate to reconsider the IPP and, for the purposes of s 54V(5), the sum sought by Transpower for DY23-DY25 is necessary and desirable to take account of the relevant regulatory change.

Our consultation process

3.20 We published our draft decision on 12 September 2023.[35] In our draft decision, we proposed to amend Transpower's IPP determination to allow Transpower to recover its actual expenditure for DY23 and forecast expenditures for DY24 and DY25. We invited stakeholders to submit on our draft decision by 26 September 2023.

No submissions received during consultation phase

3.21 We did not receive any submissions during our consultation phase.

Final decision

3.22 On the basis of the information received from Transpower, and noting that we did not receive any submissions on our draft decision, our final decision is to reconsider and amend Transpower's IPP. We consider it is necessary and desirable in accordance with s 54V(5) and consistent with the s 52A purpose, to allow Transpower to recover its actual TPM implementation expenditure for DY23 and forecasted expenditures for DY24 and DY25 by amending the Transpower IPP determination.[36]

Actual expenditure incurred for DY23

Final decision to increase Transpower's DY23 'opex allowance' for the purposes of the Transpower IPP wash-up building blocks calculation

3.23 Our decision is to increase Transpower's opex allowance that applies to Transpower's price path for DY23 by $4.3 million. This increases the total opex allowance under clause 29.1.6(c) of the Transpower IPP determination for DY23 from $286.0 million to $290.3 million.

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[35] Commerce Commission, *Reconsideration of Transpower's individual price-quality path determination in response to the Electricity Authority decisions on Transmission Pricing Methodology: Changes to expenditure allowances for costs of TPM development and implementation in the 2023 to 2025 disclosure years – draft decision*, 12 September 2023.

[36] Under s 54V(5) of the Act.

3.24 The opex allowances that were set for each disclosure year of RCP3 in the Transpower IPP determination in November 2019 are for fungible annual pools of opex. The increase for the TPM implementation opex is additional to the original DY23 amount set out in the Transpower IPP determination.

3.25 If we did not increase the pooled opex allowance for DY23, the current revenue and expenditure wash-up mechanism in Schedule E of the Transpower IPP determination would treat any expenditure on the TPM as an overspend of opex. This would not allow Transpower to record its TPM opex as a wash-up entry in its EV account, nor to recover the amount as future revenue.

3.26 The opex allowance for DY23 for TPM implementation for the purposes of the price path is calculated on a comparable basis to the amount of $286.0 million opex allowance provided for in clause 29.1.6(c) of the Transpower IPP determination. This calculation basis excludes operating lease payments capitalised in accordance with the *Transpower Input Methodologies Determination 2010* [2012] NZCC 17, as amended, (**Transpower IMs**).

3.27 The effect of making the change to the current $286.0 million opex allowance amount is that the amended opex allowance of $290.3 million will be used in the wash-up building blocks calculation under clause 29 and Schedule E of the Transpower IPP determination for DY23.

3.28 This will allow Transpower to recover the expenditure in the RCP4 price path (Transpower's next individual price-quality path that will apply for the regulatory period after RCP3). This mechanism is described in our 2019 Reasons paper.[37]

Final decision to increase Transpower DY23 'forecast opex' for the purposes of the IRIS calculation

3.29 Our decision is to increase the opex allowance that applies to Transpower's IRIS incentive for DY23 by $4.3 million. This increases the total 'forecast opex' amount under clause 33.2.3 of the Transpower IPP determination for DY23 from $296.0 million to $300.3 million.[38]

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[37] *Transpower's individual price-quality path from 1 April 2020 – Decisions and reasons paper*, 29 August 2019, Attachment J, paragraph J2.2.3.

[38] The difference in values of opex allowance for the purpose of the wash-up building blocks and forecast opex for the purpose of calculating opex incentive amount can be explained by the way the Transpower IPP treats operating lease payments. Under clause 29.1.6, the opex allowance calculation **excludes** operating lease payments capitalised in accordance with the Transpower IM. Contrast this to clause 33.2, where the forecast opex **includes** operating lease payments otherwise capitalised in accordance with the Transpower IM. This will result in a slightly higher amount for the forecast opex. We received confirmation from Transpower that the actual opex for DY23 did not include any operating lease payments so we are increasing opex allowance and forecast opex by the same amount.

3.30 The opex allowances that were set for each disclosure year of RCP3 in the Transpower IPP determination in November 2019 for the IRIS are for fungible annual pools of expenditure. The increase allowed for the TPM implementation opex in our decision is additional to the original DY23 amount.

3.31 In view of the low materiality of the amount involved, we consider the additional complexity of dealing with any expenditure variance separately from the general pool of opex is not warranted. Therefore, our decision is to increase the overall pool of approved expenditure for the IRIS instead.

3.32 If we did not make an increase to pooled forecast opex for DY23, the IRIS incentive mechanism would treat the extra expenditure on the TPM as an overspend of opex and Transpower would treat that amount as a negative incentive entry in its EV account.

3.33 The amended 'forecast opex' of $300.3 million for DY23 for TPM implementation for the purposes of the IRIS has been calculated on a comparable basis to the amount of $296.0 million 'forecast opex' provided for in clause 33.2.3 of the IPP determination.

Our final decision is to increase Transpower's DY23 'standard incentive rate base capex allowance' for the purposes of the base capex expenditure adjustment

3.34 Our decision is to increase the base capex allowance that applies to Transpower's base capex expenditure adjustment incentive for DY23 by $2.1 million. This will change the incremental approved listed project base capex determined in 2023 from $17.7 million to $19.8 million and increase the approved standard incentive rate base capex allowance from $291.6 million to $293.7 million in Schedule C4 of the Transpower IPP determination.

3.35 The base capex allowances are for fungible pools of capital expenditure. They were set for each disclosure year in the Transpower IPP determination in November 2019 for this capex incentive in accordance with the *Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination)* [2012] NZCC 2, as amended.[39]

[39] *Transpower Capital Expenditure Input Methodology Determination 2012 (Principal Determination)* [2012] NZCC 2, as amended, Schedule B1, term *d.*

3.36 Any forecast capital expenditure for the Transmission Pricing System (**TPS**) development capex for inclusion in the 'standard incentive rate base capex allowance' must be calculated on a comparable basis to the amount of $291.6 million specified by clause 31.2.5 and Schedule C4 (column 7) of the Transpower IPP determination, which excludes operating lease payments capitalised in accordance with the Transpower IMs (ie, as for the IRIS opex allowance, the base capex allowance must be calculated on an expenditure basis rather than a commissioned basis).[40]

3.37 Transpower has confirmed that the DY23 actual capex for the TPS development does not include any amounts that would be treated for financial reporting purposes as capitalised operating leases in its application. This means that all of the capex is included in the updated standard incentive rate base capex allowance.

Forecast expenditure for DY24 and DY25

Forecast opex for DY24 and DY25

3.38 With respect to the forecast expenditure, our decision is to increase the opex allowance for the purposes of the wash-up building blocks calculation and the IRIS calculation, similar to our decision above for the actual expenditure in DY23.

Our decision is to increase Transpower's DY24 and DY25 'forecast opex' for the purposes of the Transpower IPP wash-up building blocks calculation and the IRIS calculations

3.39 Our decision is to increase Transpower's opex allowance that applies to Transpower's price path for DY24 and DY25.

3.40 Our decision increases Transpower's opex allowance by:

3.40.1 $4.4 million for DY24; and

3.40.2 $3.9 million for DY25.

3.41 We will give effect to this decision by increasing the total opex allowance under the following clauses of the Transpower IPP determination:

3.41.1 clause 29.1.6(d) for DY24 from $295.5 million to $299.9 million; and

3.41.2 clause 29.1.6(e) for DY25 from $295.9 million to $299.8 million.

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[40] See Schedules C2 and C4 of the Transpower IPP determination for a comparison of the expenditure basis versus the commissioned basis treatments of capex.

3.42 The increase in the allowance will also increase the 'forecast opex' for the purposes of the IRIS calculation under the following clauses of the Transpower IPP determination:

3.42.1 clause 33.2.4 for DY24 from $305.6 million to $310.0 million; and

3.42.2 clause 33.2.5 for DY25 from $306.2 million to $310.1 million.

3.43 Our rationale for these adjustments is the same as for the adjustments in DY23 contained in paragraphs 3.30 to 3.33.

Forecast capex for DY24 and DY25

3.44 In respect of forecast TPS development capex, we considered two possible ways to amend the IPP:

3.44.1 Amend the base capex allowance for the purposes of incentives and include the capex in the MAR building block and the RAB for the revenue wash-up for DY24 and DY25; or

3.44.2 Amend the base capex allowance for the purposes of incentives and include the capex in the MAR building block and the RAB for the revenue wash-up for DY24 and amend the forecast MAR and forecast SMAR for DY25.

3.45 The different approaches result in different timing for when Transpower will recover the expenditure, but the amount recoverable by Transpower remains the same.

3.46 With respect to forecast capex for DY24, our only option is to amend the base capex allowance as DY24 started on 1 July 2023 so we cannot make any adjustments to the forecast MAR and SMAR.

3.47 While we may adjust the 'forecast MAR' and 'forecast SMAR' for DY25, we note that Transpower is seeking an adjustment of $1.9 million in capex. The forecast MAR and SMAR adjustments would be significantly less than the $1.9 million after factoring in depreciation and the WACC return. We consider this is of relatively low materiality and that adjusting the 'forecast MAR' and 'forecast SMAR' would be administratively disproportionate. As such, we consider the best option is to adjust the base capex allowance for the purposes of incentives and include the capex in the 'MAR' building block and the 'RAB' for the purposes of the Transpower IPP revenue wash-up.

3.48 Accordingly, our final decision is to increase the base capex allowance that applies to Transpower's base capex expenditure adjustment incentive for DY24 by $1.9 million and for DY25 by $1.9 million. The following changes will be made to the incremental approved listed project base capex determined in 2023 (column 6 of Schedule C4):

3.48.1 DY24, changed from $16.0 million to $17.9 million; and

3.48.2 DY25, changed from $1.9 million to $3.8 million.

3.49 The change to the approved standard incentive rate base capex allowance (column 7) will be as follows:

3.49.1 DY24, changed from $296.0 million to $297.9 million; and

3.49.2 DY25, changed from $302.1 million to $304.0 million.