

# Benefit-based charges: Covered cost

This Information Sheet describes the covered cost of benefit-based investments (BBIs). Covered cost is the total amount recovered through benefit-based charges (BBCs) for a BBI under the new transmission pricing methodology (TPM).

This Information Sheet provides an overview of:

- what covered cost is
- the components of covered cost
- how the components are calculated.

Separate Information Sheets relating to other aspects of BBCs have been published:

- the BBC simple method
- the BBC standard methods
- the Appendix A BBIs
- BBC adjustment events.

The requirements for calculating covered cost are in Part D of the TPM.

All clause references in this Information Sheet are to clauses of the TPM.



## Legal disclaimer

This Information Sheet provides a high-level overview of the relevant subject matter only.

Transpower recommends you review the new TPM itself and seek independent expert advice before relying on anything in this Information Sheet.

Transpower cannot, and does not, accept any liability for the accuracy or completeness of this Information Sheet or the consequences of your or others' reliance on it.

If you provide this Information Sheet or an extract from it to any other person you must include this disclaimer.



## Version history for this guide

Version	Published	Key amendments compared to previous version
1	10 November 2022	n/a



# 1 What is a covered cost?

Benefit based charges (BBCs) recover the costs of a benefit-based investment (BBI) from customers identified as expected beneficiaries of the BBI.<sup>1</sup>

The cost recovered through the BBCs for a BBI is referred to in the TPM as the BBI's 'covered cost'. A BBI's covered cost is calculated annually, using the same approach for every BBI.

The covered cost of a BBI includes capital components (return on and of investment) and an allocation of Transpower's total operating costs (including overheads).

A BBI's covered cost may be lumpy over its life. The reasons for this include:

- BBIs are made up of different types of assets which may have different ages and asset lives. The BBI's covered cost will vary over time as assets may be commissioned, upgraded, refurbished or replaced at different times, and due to other cost changes such as changes in interest rates.
- Some components of covered cost are a function of Transpower's regulated weighted average cost of capital (WACC) and opex allowances set by the Commerce Commission, which will change for each regulatory control period (RCP) during the BBI's life.

# 2 How is covered cost calculated?

Clauses 39 and 40 specify how covered cost is calculated.<sup>2</sup> The covered cost of a BBI comprises:

- a return of capital (depreciation) and a return on capital (capital charge)
- a tax component
- opex directly attributable to the BBI (i.e., transmission alternative opex, major capex project (MCP) opex and HVDC opex)
- other opex reasonably attributable to the BBI.

These components are calculated for each pricing year (1 April N to 31 March N+1) using inputs from the previous financial year (1 July N-2 to 30 June N-1).

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<sup>1</sup> Once a BBI investment is in service it is entered into Transpower's financial asset register, with a regulatory asset base (RAB) value (or Net Book Value in GAAP terms). The total RAB value of all grid assets is an input to the calculation of Transpower's allowable revenue as the grid owner, which is determined by the Commerce Commission.

<sup>2</sup> This Information Sheet does not cover anticipatory capacity BBIs, which are part of the TPM's Type 2 first-mover disadvantage mechanism for connection investments. The covered cost for anticipatory capacity BBIs is calculated differently.

## 2.1 Capital components

The capital components of a BBI's covered cost are:

- depreciation (return of capital) for each asset comprised in the BBI over the previous financial year, calculated in accordance with the Transpower Input Methodologies (i.e., straight line) and excluding any accelerated depreciation (clause 39(1));<sup>3</sup> and
- a capital charge (return on capital) on each asset's depreciated value at the start of the previous financial year, and on the value of each asset commissioned during the previous financial year,<sup>4</sup> calculated using Transpower's regulated WACC (clause 39(2)).

This approach ensures the capital components of covered cost for a BBI match the contribution the assets comprised in the BBI make to Transpower's regulated revenue over the life of the BBI (accelerated depreciation aside).

## 2.2 Tax component

The tax component of a BBI's covered cost is Transpower's depreciation tax loss (positive value) or gain (negative value) on each asset comprised in the BBI, and income tax on the capital charge for each asset (clause 39(3) to (5)).

The depreciation tax loss or gain is associated with timing differences between the profiles of tax and accounting depreciation for the assets.

## 2.3 Opex components

There are four categories of opex that may be attributed to a BBI (clause 40):

Opex category	Description	Attribution
<b>Transmission alternative opex</b>	The opex costs of a transmission alternative	Attributed to the BBI(s) in which the transmission alternative is comprised
<b>Major capex project (MCP) opex</b>	Any additional general opex approved in respect of the outputs of an MCP	Attributed to the BBI(s) in which the outputs are comprised
<b>HVDC opex</b>	Instantaneous reserve availability costs allocated to Transpower as	Attributed to the BBI(s) comprising investments in the HVDC link

<sup>3</sup> Commerce Commission, [Transpower Input Methodologies Determination 2010](#) (consolidated at January 2020). In the TPM, accelerated depreciation means depreciation exclusively due to damage to, or destruction, stranding, decommissioning or disposal of, an asset.

<sup>4</sup> The capital charge is scaled down proportionately if the asset was commissioned during the financial year, and asset commissioning is treated as occurring in the middle of the applicable month.

	the owner of the HVDC link and the costs of insuring the HVDC link <sup>5</sup>	
<b>Other opex</b>	Total opex (including pass-through and recoverable costs) allowance for the RCP minus the opex categories above	Attributed to all BBIs in proportion to their depreciation (excluding accelerated depreciation) during the previous financial year

The other opex category is attributed to BBIs by proxy, using regulatory (straight-line) depreciation of the assets comprised in each BBI as the basis for the attribution. A BBI's depreciation is multiplied by an attributed opex ratio to calculate the amount of other opex attributed to the BBI. The attributed opex ratio is (clause 40(3)):

- Transpower's total allowance for other opex for the RCP less an amount of opex attributable to fully depreciated assets (as determined by Transpower); divided by
- Transpower's total allowance for depreciation for the RCP, including in respect of assets not comprised in BBIs.

Because the denominator of the attributed opex ratio includes depreciation for assets not comprised in BBIs, some part of other opex is not attributed to BBIs. The share of other opex not attributed to BBIs is implicitly or (in the case of connection assets) explicitly attributed to Transpower's non-BBI and non-network assets and recovered through residual and connection charges.

The attributed opex ratio is only re-calculated during an RCP if any of the relevant allowances are reset by the Commerce Commission during the RCP.

## 2.4 Covered costs and indicative pricing

To help customers understand and prepare for pricing changes under the new TPM, Transpower published indicative prices for PY2022/23. This provides an example of what the current transmission charges would be if the TPM was applied to that year.<sup>6</sup>

The supporting information Transpower published with the indicative prices includes a covered cost model showing how we estimated covered cost for the pre-2019 BBIs in Appendix A of the TPM and the low-value post-2019 BBIs in each region.

<sup>5</sup> Most of Transpower's insurance costs relate to HVDC link assets, in particular the submarine cables, so these costs are attributed directly to BBIs containing HVDC link assets.

<sup>6</sup> See <https://www.transpower.co.nz/our-work/industry/pricing/transmission-pricing-methodology/tpm-indicative-prices>.

