TPL's Response to the Comments Made by the Minister of Finance on Reset 2015

1. Duration of the Period 2 ECC

TPL note the commentary from the Minister.

2. Allowable Rate of Return:

The following table illustrates the yearly impacts on the Statement of Financial Performance and available cash flow to operate the business and are undiscounted:

Scenario	Regulatory return on Regulatory Asset Value, post-tax real (%)	Non Fuel Starting Tariff per kWh, 1 July 2015.	Financial year ending June 30 2016	Financial year ending June 30 2017	Financial year ending June 30 2018	Financial year ending June 30 2019	Financial year ending June 30 2020	Total Undiscounted reduced profitability and cash flow
Base case	8.5%	45.25	-	-	-	-	-	-
1	8.0%	44.38	(442,848)	(460,141)	(478,114)	(496,794)	(516,210)	(2,394,107)
2	7.5%	43.51	(886,172)	(920,776)	(956,741)	(994,122)	(1,032,975)	(4,790,786)
3	6.7%	42.12	(1,594,470)	(1,656,733)	(1,721,445)	(1,788,704)	(1,858,611)	(8,619,963)

The company's business plan is finely balanced, using cashflow generated by the business and borrowings to ensure all key projects are able to be completed, operational expenditure is maintained at safe levels and agreed shareholder dividends are paid. Any reduction in the allowable rate of return will impact on this capability. Significant capex and opex cuts would need to be made.

The proposed rate of return of 8.5% real post tax represents a material reduction from the current 12.9% and is based on a standard WACC model. There is the potential to refine the calculation but we do not believe these refinements are material and we note that the Commissions Independent Consultant has agreed in principle to the proposed 8.5%.

3. Extraordinary Adjustment

TPL agree with the Minister's extraordinary tariff review trigger points except 'petroleum price crisis,' which has direct impact on the Fuel Tariff component rather than the Non-fuel tariff component.

Exclusion of Donor Funded Assets

TPL's Fixed Assets Register clearly records whether the Capex item is TPL funded or Donor funded. This is the required accounting treatment under International Financial Reporting Standards (IFRS). Typically, once donated assets are transferred to TPL they are recorded as Differed Income in the Balance Sheet and would not be included in the depreciation calculation. However the treatment in the Regulatory Accounts differs from that of IFRS and TPL's response to the Minister's clarification questions are described below:

- All gifted assets are excluded from the Regulatory Asset Value (RAV)
- Any assets operated by an independent party to facilitate a power purchase agreement are not included in the RAV
- Assets purchased/paid for the owners of distributed generation systems are not included in the RAV
- Variations from the asset management plan – Included in the RAV if the items have been paid for by TPL and, if material, approved by the Electricity Commission.

TPL notes that over time a mechanism will need to be developed that caters for the replacement of any gifted assets. Additionally the operational costs to maintain these assets are included in the calculations for the non-fuel tariff.

4. Incorporating Fuel Savings from Renewable Energy (RE)E in the Fuel Tariff Calculation Model

As the Ministry has noted, fuel tariff adjustments to incorporate fuel savings by RE generation is not unique to Period 2 - this practice has been followed during Period 1. However the proposed formulas were not shown in the Period 1 Electricity Concession Contract (ECC), due to the fact that when the Period 1 ECC was written the generation mix was diesel only. In the Period 2 ECC, TPL is proposing to include the formulas in the ECC.

TPL's feedback for Minister's comments are shown below in the order of bullet points:

- TPL calculates the fuel savings outside the Fuel Model and then imports this into the Fuel model. The savings are then reflected in the fuel tariff.
- The unit of 'fuel savings' is currency; the units of 'kWh billed' is kWh. The formula therefore yields the fuel saving in seniti/kWh which is then subtracted from the current fuel tariff component.
- Electricity generated by Distributed Generation (DG) is excluded in the Fuel Tariff Model. DG reduces TPL's non fuel revenues but fuel revenue is not lost because it is a direct pass through to the customer.
- Any non RE "firm" generation of electricity such as bio mass would be managed through another unique fuel model, as it cannot be incorporated in the current fuel model due to differences in units - e.g. diesel is measures in litres and woodchips are measured in tonnes. Additionally performance targets for the additional firm generation would need to be developed.
- Government subsidy will be translated into seniti/kWh and passed through to the customers directly without using the fuel model. The subsidy component is shown on the customer's monthly bill.

TPL would welcome the opportunity to discuss practical examples with the Ministry.

5. Monthly or Bi-monthly Fuel Tariff Adjustments

TPL considers there are no barriers to reviewing the adjustment period. TPL has previously revised fuel tariffs monthly, most recently during the significant fuel price movements experienced at the beginning of 2015.

6. Tariff other than Regulated Tariff

TPL note the commentary from the Minister.

7. Hedging of Fuel Price Volatility

TPL note the commentary from the Minister.

8. Power Purchase Agreements (PPA)

TPL note the commentary from the Minister. TPL would administer a fully transparent and open PPA negotiation process. It is important to note, however, that care must be taken when linking an Independent Power Purchasers offer price to “an average cost of generation of electricity by TPL”. The terms and conditions of the PPA must be matched against a longer term view of fuel prices and risks, not necessarily a short term view of present fuel costs.

9. Reporting

Currently, TPL publishes all regulatory reports (monthly, six monthly and annually) on the company’s website. There are some significant difference of reporting requirements from the EC and MPE (Government) and TPL is confident it is currently meeting all requirements.

10. Reset Process & Administration

TPL note the commentary from the Minister.