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Dr Patrick Strange
Chief Executive Officer
Transpower New Zealand Limited
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Dear Patrick

VERIFICATION OF TRANSPOWER'S TRANSMISSION PRICES

I am writing to you in relation to Transpower's anticipated publication of its transmission prices and to outline the Commission's expectations of Transpower under rule 9.2 of the Electricity Governance Rules 2003 (**Rules**)¹.

The Commission understands that Transpower has completed its documentation on pricing and calculated its transmission prices and intends to publish them, consistent with rule 9.2.1, by 8 December 2008. The Commission also understands that a similar internal audit process to last year's internal audit by Pricewaterhouse Coopers (**PWC**) will be undertaken and completed by 14 November 2008.

Rule 9.2.2 requires Transpower to demonstrate to the Commission that its transmission prices are consistent with the TPM. The Commission suggests that Transpower again provides PWC's internal audit report on the consistency of the prices with the TPM and a directors' statement confirming this, largely in the form provided last year. The Commission would expect this information shortly after Transpower's 2 December 2008 Board meeting.

In addition, the Commission would like Transpower to provide more detail around the process for ensuring that it has correctly assigned the Commission-approved amounts to the appropriate assets, in order to be satisfied that rule 9.2.2 is met.

Demonstration that prices are consistent with the TPM

The Commission suggests a slight amendment to the form of the directors' compliance statement from that supplied last year. The Commission requests that Transpower supply it with a directors' statement stating that:

- (a) the directors are satisfied that the transmission prices are consistent with the TPM, including that the revenue requirement has been calculated correctly, and specifically, that the Commission-approved amounts have been correctly assigned to the appropriate fixed assets included in the regulatory asset base;
- (b) the processes for ensuring consistency and calculation are robust; and
- (c) the design and implementation, and reporting of the outcome, of the internal audit, were in accordance with best practice.

¹ References in this letter to rules are to rules in section IV of part F of the Rules.

Rule 9.3.1 audit

In addition to Transpower's obligation under rule 9.2.2, the Commission has the discretion under rule 9.3.1 to appoint an auditor to confirm whether the transmission prices have been calculated in accordance with the TPM. Transpower is required to meet the auditor's costs.

The Commission has again carefully considered whether it should exercise its discretion to appoint an auditor. On balance, and provided the further information requested above is provided, it has decided that an audit is not warranted at this time for a number of reasons:

- (a) Transpower has the primary responsibility for ensuring that transmission prices are consistent with the TPM and demonstrating this fact to the Commission.
- (b) There are options available to purchasers if they are concerned about inconsistency, such as the process anticipated under rule 10.1.2 and under the benchmark agreements.
- (c) The Commission considers that the type of audit required by the Rules is at the comprehensive end of the spectrum, which would require substantial Commission and external resources and time to undertake in accordance with the Rules.

Transpower has indicated to the Commission how it proposes to demonstrate consistency with the TPM and, subject to the provision of the additional information requested above, this proposal is likely to satisfy the Commission that Transpower has demonstrated this appropriately. However, the Commission notes that it is entitled to commence an audit at any time. It will therefore watch purchasers' responses to Transpower's published prices with interest and may carry out an audit in future if there are material customer concerns about transmission prices.

The Commission also notes that the view, it understands Transpower has, in relation to the scope of a rule 9.3.1 audit, may be more limited than the Commission's view.

The Commission expects to receive the PWC internal audit report and a directors' compliance statement covering the matters addressed above in due course.

To ensure understanding of the Commission's approach with respect to verification of transmission prices applicable for 2009/10, a copy of this letter will be published on our website. The Commission also intends to publish the executed directors' statement and Transpower's internal auditor's report when they become available.

Yours sincerely



David Caygill
Chair