



Disclosure of Pricing Methodology

For Period Commencing 1 April 2010

The following information is disclosed in accordance with the Electricity Information Disclosure Requirements 2004 sections 22 and 23.

Contents

This document outlines the following

- The general approach to the methodology applied to calculate the prices for lines charges.
- The key components of the revenue required to cover costs and profits, including the cost of capital and transmission charges, together with the numerical value of each component.
- The consumer groups used to calculate the prices including;
 - The rationale for consumer grouping,
 - The method applied to determine which group consumers are in, and
 - The statistics relating to each group used in the methodology.
- The method used to allocate the components of revenue required amongst consumer groups, the numerical values of the components allocated to each consumer group and the rationale for allocation.
- Description of the method used to determine the proportion of fixed and variable charges and the rationale for these proportions.
- Other matters considered.

This disclosure is applicable to Marlborough Lines (MLL) business only and excludes the operations of the non-network business.

1 General Approach

Marlborough Lines' pricing methodology is based on the following principles:

- Ensure that costs are recovered in a fair and equitable manner.
- Comply with all industry regulatory requirements including the Low User Regulations.
- To foster and assist development and growth within the region with regards to the supply of electricity.
- To balance the efficient supply of electricity with overall investment costs and long term decisions.
- To ensure the ongoing commercial viability of MLL.
- The payments of discounts to effectively reduce electricity charges to eligible consumers.

The methodology outlined below is based on the use of three main cost drivers to allocate costs to defined consumer groups. These costs drivers are applied to each group of costs identified.

MLL will continue to pay discounts for the current financial year. The estimate of revenue in this report is prior to discounts being applied.

2 The key components of the revenue required to cover costs

Prices for network services are set to generate a required level of revenue for the coming year. This required revenue level is based on the Company's best estimate of costs for the coming period and includes an estimate of the return required for debt and equity funders of the business. The following table outlines the components of revenue required to cover costs and profits, including the cost of capital.

Table 1. Marlborough Lines Cost Components

Cost Category Network Business	FY2011 Est.
	000s
System Operations & Maintenance	9,814
Administration & Overheads	5,248
Transmission Costs, including Avoided Transmission	4,808
Depreciation	6,832
Return on Capital	12,464
Total Costs	39,166

Marlborough Lines' required return on capital, as in the above table, is based on 8.00% times the regulatory asset base of \$155.8m last disclosed as at 31 March 2009. The current estimate of the network business' cost of capital is 8.09%. The calculation of this estimate and the components are outlined in the following Table 2.

Table 2. Marlborough Lines Estimate of Weighted Average Cost of Capital

WACC = $R_d(1-T_c)D/V + R_eE/V$		8.09%
Rd	pre-tax cost of debt	7.40%
Tc	corporate tax rate	30.0%
Re	cost of equity	10.03%
D	target debt to debt + equity ratio	40.0%
E	target equity to debt + equity ratio	60.0%
V	D + E	100%
Cost of Equity = $R_f(1-T_i) + B_eMRP$		10.0%
Rf	rate of return on risk free asset	5.4%
Ti	investor tax rate	30.0%
Be	equity beta	0.83
MRP	market risk premium	7.5%
Ba	asset beta	0.50

3 Consumer groups

Five consumer groups were established by assessing end use and capacity (kVA). The five consumer groups are Group 1 - residential, Group 2 - small commercial, Group 3 - medium commercial, Group 4 - large commercial, and Group 5 - irrigation.

Consumers are initially categorised as being residential or non-residential. The classification of a consumer into residential or non-residential use is based upon their predominant end use.

Residential consumers have different consumption patterns from businesses and have a higher proportion of their total load associated with water and space heating. Water and space heating loads are generally able to be interrupted by the Company's ripple control system. The different characteristics of residential consumers compared to businesses consumers make it logical to have a residential consumer group.

Non-residential consumers are divided into three groups depending on the maximum capacity supplied to the installation (kVA capacity). Groups 2 and 3 are small commercial customers. Group 4 includes customers that are required to have Time of Use (TOU) metering as they have demands in excess of 140kVA. Group 4 also includes large customers with 11kV supplies.

The grouping of most of the non-residential consumers by capacity supplied was considered to be the best way to reflect the initial and ongoing investment made, the maintenance costs required and the contribution to peak demands.

Group 5 is an irrigation consumer group which includes both low and high kVA capacity consumers. These users have a distinct pattern of consumption and have therefore been grouped separately from other commercial users.

Table 3. Consumer Groups

Group	Description	Price Code	No of ICPs
Group 1	Residential	DS	20,461
Group 2	Non-Residential < 41kVA	NS	2,915
Group 3	Non-Residential 42 to 140kVA	RT	380
Group 4	Non-Residential > 140kVA includes 11 kV	BF	118
Group 5	Irrigation	PM	331
Total			24,205

4 Allocation Method and Rationale - Allocation of the components of revenue required to cover the costs

The allocation of costs to consumer groups is based on three cost drivers. The three cost drivers identified and applied are kWhs consumed, kVA capacity installed, and number of ICPs.

MLL considers that the cost drivers have been calculated on an objective basis. The intention is also for each cost driver to provide a substantive relationship to the underlying activity driving each respective cost.

Table 4. Calculation of cost drivers to each Consumer Group

Cost Driver	kWh	kVA	No. ICPs
% of cost driver for each consumer group			
Group 1	42.0%	62.7%	84.5%
Group 2	10.7%	15.2%	12.0%
Group 3	9.9%	6.0%	1.6%
Group 4	32.8%	11.3%	0.5%
Group 5	4.5%	4.8%	1.4%
Totals	100%	100%	100%

Each group of costs identified (outlined in Table 1.) has then been allocated to each of the consumer groups based on the best deemed cost driver or mix of cost drivers.

Four cost categories, Systems Operations and Maintenance, Transmission Costs, Depreciation, and Return on Capital, are considered to be driven by asset related costs. Allocation of investment, maintenance and other asset related costs are soundly represented by kVA and kWh cost drivers. This allocation method also assists future decisions regarding asset related investments and required returns for the business.

Administration and overhead costs are considered to be driven by consumer activity, which is best characterised by the number of ICPs and kWh cost drivers. Both of these cost drivers represent a broader level of consumer use and activity rather than the level of installed capacity.

Table 5. Allocation of Revenue Required/Costs to Consumer Groups

Cost Categories	System Operation & Maintenance	Administration & Overheads	Transmission Costs	Depreciation	Return on Capital	Total
Allocated Cost Drivers	KWH / KVA	ICPs / KWH	KWH / KVA	KWH / KVA	KWH / KVA	
Group 1	5,141	3,321	2,320	3,579	6,530	20,890
Group 2	1,271	597	580	885	1,614	4,948
Group 3	778	301	419	542	989	3,029
Group 4	2,165	874	1,267	1,507	2,749	8,562
Group 5	458	155	222	319	582	1,737
Totals	9,814	5,248	4,808	6,832	12,464	39,166

5 Fixed and variable proportions

The proportion of fixed charges versus variable charges has been based on historical pricing methodologies. MLL has maintained this pricing mix to provide consistent pricing signals to consumers.

The introduction of the low user daily fixed charges for domestic consumers has to some degree challenged the efforts made to accurately recover costs fairly from all consumers. MLL has partially addressed the cross-subsidisation inherent in the low user tariff by obtaining an exemption from offering the low user fixed charge option to domestic consumers who are located in remote areas of the network.

The proportion of line charges currently being charged is 31% fixed, 47% variable and 22% demand based charges. Demand based charges only apply to Groups 4 and 5.

Variable charges are generally higher for lower capacity (kVA) users, including Groups 1, 2 and 3. This has been instituted to Groups 1, 2 and 3 to reflect the patterns of supply with non half-hourly metering, lower investment costs to add a new consumer, and as supplies for water heating are generally controllable (mostly for Group 1 customers).

Fixed charges are generally higher for higher capacity (kVA) users including Groups 4 and 5. This is designed to reflect investment costs associated with peak demand, which is measured with half-hourly metering equipment.

MLL assesses that most of its costs outlined above are actually fixed. If MLL were to recover its fixed proportion of costs in fixed charge tariffs the fixed charge proportion would need to increase.

6 Other Matters

A charge for reactive energy, where power factors are below 0.95, is levied to encourage investments in improving power factors.

The current MLL pricing schedule can be sourced from the following website reference:

<http://www.marlbroughlines.co.nz/Disclosures/Pricing>