



**Submission to Commerce Commission on
Draft Information Request and Process
Update**

28 February 2011

Introduction

1. Vector welcomes the opportunity to provide this submission on the Commerce Commission's (**Commission**) consultation paper on *Draft Information Request and Process Update* for the Electricity Distribution Business Default Price-Quality Path starting price adjustment.
2. Vector's contact person for this submission is:

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Broad comments on the information request

Scope of the information request

3. Vector is pleased that the Commission is seeking information for the 2010 year only. To provide revised information for more than one disclosure year would be onerous and very challenging to deliver to audited standards in the timeframe available.
4. The Commission appears to be seeking information (e.g. restatement of 2009 asset valuations to unallocated amounts; proportionate values of commissioned and disposed assets) that is not required by the input methodologies. The input methodologies were developed through a lengthy process of detailed consultation and comment and are subject to merits review challenge. The creation of new requirements now with only two weeks for consultation risks poor decisions and new requirements that are not fit for purpose. Vector recommends that the Commission adhere to the input methodology requirements for the asset adjustment process and avoid creating new processes by way of statutory notice.
5. The draft schedules do not let the Electricity Distribution Businesses (**EDBs**) determine their own key data (e.g. ROI or regulatory tax allowance) and have those results audited. Instead the Commission will take the data reported and make a judgement about how to use them. This is not good regulatory practice – the Commission should enable EDBs and their auditors to assess the final set of regulatory financial statements that will determine any starting price adjustment.

The information request should be based on the electricity information disclosure templates

6. We recognise that the Commission has approached this request from the position of gathering information to input into its starting price adjustment model. This is understandable but creates difficulties for suppliers and their auditors.
7. Vector submits that the Commission needs to make the information request easier for suppliers to comply with and auditors to check compliance. If it does not do so it risks auditors being unable to provide unqualified opinions by 27 May due to the complexity of the new input methodologies.
8. This information request creates a very large workload for auditors. It is a challenging request to ask the auditors to provide approval that the information provided complies with the input methodologies in total. The process would be significantly less onerous and capable of earlier completion if the requirements were specified differently.
9. In addition, without any reconciliation back to audited 2010 disclosures there many potential ambiguities and possible misinterpretations that could arise. This is because businesses are being asked to interpret and apply the IM determinations themselves without access to a set of information disclosure guidelines.
10. Vector recommends that the Commission provide the information request based on the electricity information disclosure requirements (schedules FS1, FS2, FS3, AV1, AV4 if relevant, and the ROI performance indicator part of MP2). The information request should specify the current information disclosure requirements, the new input methodology requirements and the differences between the two. This would enable the calculation of an adjusted ROI and other core data (e.g. regulatory tax allowance) in the information request. This will aid transparency about the changes to the methodologies and make the task more straightforward
11. Our proposed approach will demonstrate the differences between previously disclosed data and newly disclosed data and the resultant ROI and other performance measures. It will provide experience with applying the input methodologies in the context of information disclosure, noting the Commission's statement that "[t]he Draft Notice ... has been designed to obtain information... that is consistent with the type of information that would be made available via the information disclosure requirements that

utilise the input methodologies”.¹ Vector supports the ENA’s proposed alternative templates that deliver this approach.

The engineer’s report should be simplified and aligned to what EDB asset registers can deliver

12. The Commission’s requirements for the engineer’s report are onerous, not the most cost-effective means of gaining the desired level of assurance and require engineers to audit processes outside their area of expertise.
13. The draft information request seems to be based on a misapprehension of the nature of electricity distribution asset registers. Vector has approximately 1 million assets in our electricity distribution business asset register. Many hundreds of thousands of these have low values. We do not have the data at a sufficient level of disaggregation in 2009 to comply easily with the Commission’s request. As the Commission is aware, assets were valued in 2004 and have since been rolled forward at an aggregate level. We therefore do not have 2009 disclosed values for individual assets. To try to identify individual assets at 2009 and match them with assets at 2004 and then roll forward the adjusted values is a highly complex task.
14. In fact, to comply with the information request we would have to estimate 2009 unadjusted values for each asset by rolling forward from the most recent ODV valuation to 2009. Then we would have to re-do this roll forward *for each adjustment*, both individually and in aggregate because the adjustments impact on each other, and identify the individual adjustment effects.
15. Further, engineers are generally not seen as experts in the practice of rolling forward, adjusting for indexation and depreciation. It is best for financial auditors to certify the process. Our auditors have been familiar with checking these processes for several years in the context of the current information disclosure requirements.
16. Vector recommends that the Commission instead provides for suppliers to undertake the process of asset adjustment at 2004. The engineer can then check these adjustments and provide a report to the Commission. The adjusted 2004 values can then be rolled forward at an individual asset level to 2009, with that roll-forward being reviewed by the auditor.
17. Any corrections to other assets included in the 2009 disclosure value (being assets commissioned since 2005) – could also be verified by an engineer consistent with the input methodologies. The inclusion of load control relays at 2009 could also be reviewed by the engineer.

¹ Commerce Commission, *Consultation Paper on Draft Information Request and Process Update*, 14 February 2011 , paragraph 5.

18. This would be a more straightforward and easier approach, with less risk of error and a far greater likelihood of being completed in time for the 27 May deadline.
19. The draft information request also asks suppliers to essentially re-run the asset register databases in different ways to identify the exact value impact on individual assets of each modification. The time and effort required for such a task should not be underestimated. In particular, some changes to multipliers and other adjustments compound each other and identification of which changes in value can be ascribed to which adjustment process may be arbitrary. Because of this, the sum of individual adjustments is unlikely to equal the aggregate adjustment. As an alternative, Vector suggests that, in stipulating the engineer's requirements, the Commission enable the adjustments to happen sequentially with the additional value impact of each sequential adjustment being reported.

Implications for gas pipeline businesses

20. Vector notes the Commission's statement that the type of information required for electricity is also likely to be required for gas pipeline businesses. The problems identified above are significant for electricity but for gas pipeline businesses would be even more challenging. For more information on the problems inherent in adjusting the valuations of Vector's gas pipeline businesses, we refer the Commission to the statement by Duncan Ian Head of 23 August 2010 in response to the Draft Decision on the Asset Valuation Input Methodology². Mr Head's statement provides the detailed background that it is necessary to understand before making decisions on how to adjust the gas valuations.
21. Vector strongly submits that the Commission should not view the comments provided in this consultation process on the gas pipeline businesses as sufficient consultation on a future statutory notice for gas pipeline information. Vector recommends the Commission consult fully on the statutory notice for gas also as the GPBs have some different challenges from the EDBs and we have not had time to fully consider these as our focus has been on the electricity business.

Normalisation

22. The Commission seeks data for one year only and is likely to use that data to inform starting price adjustments. While we welcome this it is not clear how the Commission proposes to identify normalisation issues. Vector

² <http://www.comcom.govt.nz/assets/Pan-Industry/Input-Methodologies/Draft-Reasons-Papers/Draft-Reasons-EDBs/AssetValuationSub/Vector-Attachment-Submission-on-EDBs-and-GPBs-Input-Methodologies-Asset-Valuation-Duncan-Ian-Head-Statement-Public-23-August-2010.pdf>

recommends the information request include a facility for suppliers to notify the Commission if the data for the 2010 year is unusual in any way.

Advice and guidance from the Commission

23. Vector recommends that the Commission make staff available during the period mid-March to 27 May 2011 to answer questions and provide clarification in a timely manner to EDBs where required. This will be essential to ensure there is clarity and EDBs can effectively resolve issues and uncertainty and satisfy the timeframes in the Draft Notice.

Implications for other EDB audits

24. Audits of EDB's price-quality performance generally start in late April. These audits tend to involve the same internal staff and external auditor resources as will be involved in the information request. We note that many EDBs also have their financial year end and associated audit process over this timeframe. It would be helpful for work scheduling and to ensure that the information request receives the attention it requires if the deadline for the 2010/11 Electricity Thresholds Compliance Statement could be deferred for one month.
25. In addition, it is clear that the new input methodologies make the current information disclosure regime out of date and that information reported from this point on under current information disclosure requirements will be of limited use as it will be based on different definitions, calculations and requirements. On that basis, Vector recommends that the current information disclosure requirements are suspended, with all future disclosures being made under the new Information Disclosure Requirements that will be developed by December 2011 and that are based on the input methodologies. This will reduce unnecessary costs for all parties and will also reduce the risk of congested schedules being created by the deferral of the 2010/11 Compliance Statement.

Detailed comments on the Commission's schedules

26. The formulae in the spreadsheets seem to be incomplete and it is not clear how information will flow between schedules. This has made it difficult to interpret the information flow between the schedules.

Schedule A1 – Regulatory income and expenses

27. This schedule is not a complete regulatory income statement and there is insufficient detail in this schedule to determine the likely impact on key financial indicators that will influence the ROI calculation of EDBs.

28. It is also unclear how loss rental rebates and 2010 Commerce Commission levies will be treated.

Schedule A2 – Allocation of operating costs 2010 and Schedule A5 - Allocation of unallocated RAB values 2010

29. Schedules A2 and A5 require regulated firms to break down costs and asset values across electricity distribution, gas distribution, gas transmission and unregulated services.
30. It is unnecessary to require costs and asset values to be split out for each of gas distribution, gas transmission and unregulated services at this stage. As the gas and electricity disclosure years are different, gas transmission and distribution allocation will need to be done for years ending 30 June. Therefore, if allocations carried out for this electricity information request, that information will not be the same as when carried out for the gas disclosure year. It is likely to be less confusing if the allocations to gas distribution, gas transmission and unregulated businesses were not disclosed at this point.
31. Vector has prioritised tasks in order to meet the timing of anticipated information requests and starting price adjustments. Therefore we have aimed to complete adjustments to the electricity distribution asset valuation prior to completing adjustments to the gas pipeline asset valuations. This mirrors the Commission's own sequence for setting the regulatory requirements of the respective regulated services. It will be extremely challenging (if not impossible) for Vector to provide audited and fully adjusted gas asset valuations by 27 May and any allocations will likely be based on provisional or most recently reported values for the gas businesses.
32. Vector does not agree with the Commission's apparent intention that information about operating costs and asset values of unregulated businesses are made public, as this is in excess of the requirements for other statutory disclosures (e.g. audited financial statements). These businesses operate in competitive markets and to release this information would put the unregulated businesses owned by EDBs at a disadvantage to their competitors, particularly where an EDB owns just one unregulated business. There is no need for this information to be made public in order to make a starting price adjustment.
33. Vector recommends that the statutory notice only requires allocation of costs into two pools only: (1) the electricity distribution business and (2) other businesses owned by the EDB.
34. That will be sufficient for the Commission's purposes as the break down of information between non-EDB businesses is irrelevant to the electricity

starting price adjustment decision and not useful for gas decisions either as it will not align with gas disclosure years. It will be possible to audit the accuracy of the allocations without splitting costs across all regulated businesses and the unregulated businesses.

35. In addition, the formulae on Schedule A3 make it unclear how the information on Schedule A5 will be used, specifically whether the addition of system-fixed assets in this schedule will lead to double counting when the results are transferred to Schedule A3.
36. Vector is also unclear whether proxy allocators need to be derived for both the year ending 31 March 2009 and the year ending 31 March 2010 to allocate costs. Vector recommends that only one set of allocators for EDBs is derived as at 31 March 2010.
37. These schedules do not seem to address asset disposals.

Schedule A3 – Regulatory asset base values 2010

38. Row 9 – Vector assumes that the Total Regulatory Asset Base Excluding FDC item is the opening asset values for 2010.
39. Row 10 – The meaning of this row is unclear. Vector recommends that the definition refers to any ACAM adjustments to opening asset values.
40. Rows 16 and 17 – Intangible assets and Works under construction are not included in the electricity Regulatory Asset Base so it is not possible to deduct them from the RAB. It seems that the schedule has been designed to match the input methodology definitions rather than the data that is included in disclosed asset values. Our assumption is that both Works under construction and intangible assets should therefore be given zero values in responses to the electricity distribution information request. We would welcome confirmation of this from the Commission. On that basis, Vector recommends an amendment to row 12 to change the word “less” to “to the extent that these items are included in the value at row 11, less”.
41. Row 20 – Vector does not support the deduction of the value modified assets number. It will be very challenging for EDBs to identify this value. Vector recommends the Commission instead use the ENA templates which provide a solution to this issue.
42. Row 22 – this row implicitly includes non-system fixed assets. However, the next row then applies the FDC allowance of 2.45% only to the system fixed asset values in this row. The system fixed asset value should be broken out so FDC is not applied to non-system fixed assets (e.g. by deducting non-system fixed assets and adding it back after FDC is calculated).

43. Rows 32 to 48 – It is unclear why this information is needed or what it will be used for. The Commission should only require information where it has a clear and justifiable purpose.
44. Rows 40 and 46 – Vector strongly opposes the new requirement to calculate the proportionate value of disposed and commissioned assets. Vector adds over 50,000 assets to its asset register every year (approximately 150 per day). It is unreasonable to ask Vector to calculate the proportionate value of every single asset that is commissioned and disposed during the 2010 disclosure year. These data are not readily available and it would be a time-consuming task to derive them. This approach is also inconsistent with the roll-forward methodology in the current information disclosure requirements. The current methodology of assuming additions are added evenly over the course of the year is significantly more straightforward and sufficiently accurate for the purposes of calculating an ROI. Vector recommends that the current methodology be used in preference to the proportionate approach.

Schedule A4 – Asset adjustment process

45. Vector would prefer to report the modified 2004 value and then roll that new value forward using the methodology as set out in the Information Disclosure Requirements 2008. It will be extremely challenging to identify the modification impacts by asset category at 2009. It would be much more straightforward to measure the impacts at the time the asset enters the asset register (2004 for all assets commissioned by 31 March 2004, or at commissioning date for all assets up to 31 March 2009). More detail on this point is outlined in the discussion regarding the Engineers Report above.
46. It is unclear why this schedule is necessary as the details of the asset adjustment process are not essential for starting price adjustment decisions. Providing the engineer and auditor have approved the asset adjustments, there should not be a need to report them in this level of detail.

Schedule A6 – Regulatory tax information

47. This schedule appears to be incomplete as it does not derive the regulatory tax allowance for the EDB and allow that to be audited.
48. The schedule only seeks a few rows of information. However, the regulatory tax input methodology requires a large number of calculations in order to derive the positive and negative permanent differences. The deferred tax approach is new to all EDBs and the Commission is essentially requiring each EDB to make its own interpretation of these calculations, without help or guidance from the template. This is likely to lead to variations in approaches across EDBs and also create confusion and additional work for EDBs and their

auditors as they attempt to comply with the input methodology determination.

49. Vector recommends that the Commission provide a more detailed schedule that sets out the steps by which the regulatory tax allowance is derived. Failing that, the Commission should provide worked examples to demonstrate to the industry how the calculations should be made and ensure consistency across the industry.

Schedule B – Debt information

50. The information provided by EDBs in this schedule must be kept confidential. The Commission should make this clear on the schedule.
51. Inclusion of the coupon rate is superfluous for the calculation of the term credit spread differential as set out in the determination. Fundamentally the cost of debt to the EDB is what is relevant; i.e. the credit spread over the relevant bond (swapped back to NZ dollar where applicable) rather than the coupon rate.
52. The determination of the term credit spread differential requires the following company specific information which should be captured via schedule B:
- Book value in New Zealand dollars of qualifying debt at its date of issue - 2.4.9(3)(b), 2.4.10(1)(b);
 - Book value in New Zealand dollars of the qualifying supplier's total interest bearing debt as at the date to which the supplier's financial statements audited and published in the disclosure year in question relate - 2.4.11(3)(b);
 - the original tenor of the qualifying debt – 2.4.10(2)(a) & (b); and
 - the pricing date of the qualifying debt – 2.4.10(2)(e).
53. Other information required to calculate the term credit spread differential should be determined elsewhere, i.e. leverage is specified at 2.4.2(1) and opening RAB values and closing RAB values should be determined from a more appropriately constructed Schedule A3. It does not seem possible to determine the closing RAB values from the data requested in the Draft Statutory Notice. Vector recommends the Commission seek sufficient information regarding the closing RAB value in order to calculate the term credit spread differential.
54. Vector assumes the reference to "most recently published financial statements" refers to the financial statements published most recently prior to 31 March 2010 rather than 27 May 2011. We would welcome confirmation of this point.

Schedule C – Information required for Engineers Report

55. See discussion of the engineers report in paragraphs 12-19 above.
56. In addition, clause 2(e)(ii) on page 18 has the effect of requiring an auditor to check some valuation adjustments and then provide a report on those points to the engineer. The engineer's report will then be reviewed by auditors as they check data reported in the statutory notice. This is a rather convoluted process of providing reports in order to reference other reports. Vector recommends that the engineer's report is completed first and all audit work is completed after the engineer's report.
57. To avoid any risk of misinterpretation, the Information Request should state that Table 1 in Schedule C is intended to be a summarisation of the requirements of the Electricity Distribution Input Methodology Determination and that the Determination is the authoritative document if there is any apparent contradiction or lack of clarity.

Comments on process update

58. Vector considers that the proposed timeframes for the starting price adjustment consultations (5 weeks for submissions with 2 weeks for cross submissions for both the Update Paper and the Draft Decisions Paper) are the bare minimum for consultations on a subject with such a significant value impact on EDBs. We strongly submit that these timeframes should not be shortened.