

**Submission on Information Disclosure:  
Approaches for Understanding EDB and GPB Cost  
Efficiency**

From the Electricity Networks Association

11 November 2011

## Electricity distribution businesses supporting this submission

The electricity distribution businesses listed below support this submission.

Alpine Energy Ltd  
Aurora Energy Ltd  
Buller Electricity Ltd  
Centralines Ltd  
Counties Power Ltd  
Eastland Network Ltd  
Electra Ltd  
Electricity Ashburton Ltd  
Electricity Invercargill Ltd  
Horizon Energy Distribution Ltd  
Mainpower NZ Ltd  
Marlborough Lines Ltd  
Nelson Electricity Ltd  
Network Tasman Ltd  
Network Waitaki Ltd  
Northpower Ltd  
Orion New Zealand Ltd  
OtagoNet Joint Venture  
Powerco Ltd  
Scanpower Ltd  
The Lines Company Ltd  
The Power Company Ltd  
Top Energy Ltd  
Unison Networks Ltd  
Vector Ltd  
Waipa Networks Ltd  
WEL Networks Ltd  
Wellington Electricity Lines Ltd  
Westpower Ltd.

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# 1. Introduction

1. The Electricity Networks Association (ENA) appreciates the opportunity to submit on the Commerce Commission's (Commission's) technical consultation paper on Information Disclosure: Approaches for Understanding EDB and GPB Cost Efficiency (the Consultation Paper)<sup>1</sup>. This submission is structured along the following lines:
  - Consideration of an alternative approach;
  - Discussion of objective and purpose of the Commission's summary and analysis of Information Disclosures (ID) including an overview of the regulatory framework in which proposed ID summary and analysis is to be conducted;
  - Consideration of the implementation principles relevant to ID, which should be used when scoping ID requirements and the Commission's summary and analysis role;
  - More detailed consideration of the proposals for opex and capex efficiency assessments; and
  - Responses to the question raised in the Consultation Paper.

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<sup>1</sup> *Technical Paper for Consultation: Information Disclosure: Approaches for Understanding EDB and GPB Cost Efficiency*, Commerce Commission, 7 October 2011

## 2. Summary

2. There are a number of technical issues with the proposed benchmarking approach that will make it difficult to draw meaningful and robust conclusions on comparative efficiency in a cost effective way. Accordingly the ENA recommends the Commission implement a less intensive and costly assessment approach, based largely on existing disclosures, before determining whether more extensive analysis may be required to meet the purpose of ID at some time in the future. The ENA supports more focus on individual company performance over time rather than comparative performance.
3. The ENA submits that the objective of the cost efficiency assessment proposal has not been adequately specified by the Commission and does not align with the purpose of ID. The analysis function is intended to be used for monitoring whether the purpose of Part 4 is being met. The purpose of ID is not to implement or specifically inform price-quality regulation. The proposed approach goes beyond the monitoring objective of ID, and hence the information requirements necessary to implement the proposed approach are excessive. Accordingly the ENA submits that the Commission should:
  - Firstly specify the information interested persons require to assess whether the purpose of Part 4 is being met by regulated suppliers, taking into consideration the incentives which exist for suppliers through price-quality regulation and consumer ownership;
  - Secondly consider whether the information which is already disclosed meets this purpose, and if necessary identify information gaps;
  - Thirdly consult on the information requirements required to meet the ID purpose, and following consultation, implement them; and
  - Finally given the information disclosure dataset developed in steps 1-3, prepare its summary and analysis of the information which is disclosed.
4. Greater consideration of how the wider regulatory framework incentivises efficient behaviours, consistent with the Purpose Statement is required. In addition, the role of other ID information is not adequately considered. The incentives faced by exempt EDBs via their ownership arrangements should also be considered. ID is not a stand-alone regulatory mechanism and the ENA submits the Commission must consider the incentives provided to regulated suppliers in meeting the objectives of Part 4 via:
  - Input methodologies;
  - Price-quality regulation;

- Consumer ownership; and
  - Existing information disclosures.
5. The Consultation Paper attempts to set out an approach and define information requirements without providing an indication of the outputs the Commission considers it will generate as a result of the analysis. We suggest it is the outputs which should be defined initially before information requirements and model specifications are developed. Accordingly the ENA submits that the Commission needs to be very careful about how it develops and presents its proposed cost efficiency analysis, to ensure the incentives it will create are not contrary to the Purpose Statement, particularly in respect of the requirements to ensure sufficient incentives to invest and innovate and meet consumer demands.
6. The proposed analysis does not align with the Commission’s previously stated information disclosure implementation principles. In particular, it is excessive and costly and does not adequately consider the information already provided by EDBs. The Consultation Paper includes no assessment of the cost -benefit of the proposals. The ENA expects that the information gathered as part of ID should be no more than that which is sufficient to meet the purpose of ID. Accordingly the ENA submits that before the Commission proceeds with its cost efficiency proposals it reassesses the proposals, and potential alternatives against the following implementation criteria:
- Cost effectiveness;
  - Consistency;
  - Transparency; and
  - Flexibility.

### 3. An Alternative Approach

8. After fully considering the Commission's proposed approach in the context of the purpose for ID and the overall regulatory framework for EDBs the ENA recommends the Commission implement a less intensive and costly assessment approach in the first instance, before determining whether more extensive analysis may be required to meet the purpose of ID at some time in the future.
9. We suggest that the Commission should more fully consider the existing information disclosure data possibly supplemented by a qualitative assessments (such as of the AMPs) with EDBs given the opportunity to explain their performance prior to publication.
10. We submit that a comparison of individual company performance over time would provide a more meaningful insight to performance than comparative performance assessments. We believe this will allow the Commission to meet its summary and analysis obligations while ensuring interested persons have sufficient information available to them to assess performance of EDBs against the 52A purpose statement.
11. In this respect we invite the Commission staff to visit our members to gain a better understanding of the way in EDBs manage their businesses, the information they use and the local network and scale differences across the sector. The ENA would be pleased to assist in arranging such visits if this would be helpful to the Commission.

### 4. Regulatory Context

12. The Consultation Paper outlines proposals for the Commission's assessment of EDB and GPB cost efficiency for the purpose of undertaking summary and analysis of information disclosed under Part 4 of the Commerce Act.
13. The Consultation Paper however does not adequately consider the proposed cost efficiency analysis in the context of purpose for ID. It thereby risks over-specifying the Commission's summary and analysis role. This has consequences for compliance costs for regulated suppliers and administration costs for the Commission, which are ultimately passed onto consumers via the Commerce Act Levy.

#### Overview of summary and analysis requirement

14. The Commission is required under section 53B(2) of Part 4 of the Commerce Act 1986 (the Act) to summarise and analyse ID. Section 53B(2) states that:

*If a supplier of goods and services is subject to information disclosure regulation, the Commission –*

(a) *may monitor and analyse all information disclosed in accordance with the information disclosure requirements; and*

(b) *must as soon as practicable after any information is publicly disclosed, publish a summary and analysis of that information for the purpose of providing greater understanding of the performance of individual regulated suppliers, their relative performance, and the changes in performance over time.*

15. The clear objective of this clause is to provide interested persons with ‘greater understanding’ of individual supplier ‘performance’. This greater understanding is to be achieved through publication of summaries of disclosed performance and through the provision of some analysis relating to individual supplier performance; both relative and over time.

### **Purpose of information disclosure**

16. The purpose of ID regulation is to ensure sufficient information is available to interested parties to allow them to assess whether the overarching Part 4 purpose statement is being met. Any summary and analysis generated by the Commission under section 53B(2) must be consistent with this purpose.

17. Specifically, section 53A states that:

*The purpose of information disclosure regulation is to ensure that sufficient information is readily available to interested persons to assess whether the purpose of this Part is being met.*

18. Reference to the ‘purpose of this Part’ above is reference to the 52A purpose statement.

19. This 53A purpose for ID differs to the previous Part 4A purpose for ID, which was set out in (the now superseded) section 57T as follows:

*The purpose of this subpart is to promote the efficient operation of markets directly related to electricity distribution and transmission services by ensuring that large line owners and large electricity distributors make publicly available reliable and timely information about the operation and behaviour of those businesses, so that a wide range of people are informed about such factors as profits, costs, asset values, price (including terms and conditions of supply), quality, security, and reliability of supply of those businesses.*

20. The purpose for information disclosure regulation under Part 4A was to directly promote the efficient operation of markets. However, under the new Part 4 the purpose of ID is to “assess” rather than “promote” performance. This refinement to the role of ID under Part 4 must be viewed in the context of the other regulatory provisions which now exist for EDBs. Part 4 introduced

default/customised price-quality control. This is more explicit regulation of price and service quality than that previously provided for by the thresholds which existed under Part 4A. In addition, in recognition of the incentives for suppliers to provide price and quality performance consistent with consumer demands, Part 4 introduced exemption from price-quality control for the EDBs which meet specific consumer ownership criteria.

21. Accordingly ID is one of the regulatory mechanisms which contribute to meeting the objectives of Part 4, along with price-quality regulation and consumer ownership. Importantly, the purpose of ID as set out in section 53A is to ensure sufficient information is available for interested persons to assess the performance of regulated suppliers against the section 52A purpose statement.

### **The cost efficiency proposals**

22. The Consultation Paper outlines the Commission’s preliminary views on proposed assessments of the cost efficiency of suppliers for the purpose of undertaking summary and analysis of ID information. The Consultation Paper suggests that a comparison of expenditure across operators and an examination of cost trends will address part of the 53B(2)(b) requirement to understand performance of suppliers.<sup>2</sup> Discussion then immediately turns towards a detailed overview of the mechanics of the proposed analysis, focussing on model specification and data selection issues.
23. By contrast, the Consultation Paper devotes very little time to outlining the purpose and objective of the Commission’s summary and analysis role. For instance, there is little consideration of what is meant by ‘performance’ and there is no discussion of the ‘greater understanding’ the proposed analysis is intended to highlight to ‘interested persons’ or what is “sufficient information”. Consideration of these fundamental issues is important, to defining the scope of analysis and the level of input information required to undertake it.

### **Recommendation**

24. The overarching purpose for ID, along with other incentives for behaviour consistent with the section 52A purpose statement must be considered when specifying the information to be disclosed by regulated suppliers, and the scope of the Commission’s monitoring and analysis. Accordingly the ENA submits that the Commission should:
  - Firstly specify the information interested persons require to assess whether the purpose of Part 4 is being met by regulated suppliers, taking

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<sup>2</sup> Consultation Paper paragraph 1.4

into consideration the incentives which exist for suppliers through price-quality regulation and consumer ownership;

- Secondly consider whether the information which is already disclosed meets this purpose, and if necessary identify information gaps;
- Thirdly consult on the information requirements required to meet the ID purpose, and following consultation, implement them; and
- Finally given the information disclosure dataset developed, prepare its summary and analysis of the information which is disclosed.

### **Other safeguards and tools**

25. Consideration of the wider regulatory context in which the summary and analysis sits is important. As stated above the Commission has other regulatory safeguards and tools available to it under Part 4. Any analysis developed in isolation of these, risks over-specification and unnecessary cost. Accordingly, the ENA submits that the Commission must consider the following safeguards and regulatory tools when specifying its information disclosure requirements:

- *Input methodologies:* Input methodologies have been specifically developed to provide safeguards that the purpose of Part 4 is being met. Any analysis framework should ideally focus only on the areas of residual risk that may remain after IMs have been applied.
- *Price-quality regulation:* DPPs (and CPPs) are designed to explicitly address the requirements of the Purpose Statement, by providing incentives for businesses to behave consistently with each of the strands in the Purpose Statement. This includes incentives for efficiency, for sharing efficiencies with consumers and to innovate and invest. Price and quality performance consistent with the DPP (or CPP) therefore must demonstrate acceptable behaviour.
- *Consumer ownership for exempt EDBs:* Consumers influence the behaviour of exempt EDBs through their consumer representatives which appoint Directors and agree performance objectives with Directors and Management. These include price, profit and service level targets.
- *Existing information disclosures:* The existing disclosures include a range of information, including prices, profits, Asset Management Plans (AMPs), service levels, costs and network characteristics which provide considerable information about the performance of each EDB.

26. Importantly the statutory purpose of ID, and therefore the Commission's summary and analysis is not:

- To collect information required for price-quality regulation (although ID information may be one source of information available to the Commission for this purpose, it is not the purpose of ID); or
  - To scrutinise asset management opex and capex such as required for a CPP.
27. Rather the primary purpose for performance analysis is to act as a high-level reasonableness check on the veracity of the regulatory framework; ie: on whether the purpose of Part 4 is being met.

### **Recommendation**

28. That the Commission acknowledges that the primary purpose for ID performance analysis is to act as a high-level reasonableness check on the veracity of the regulatory framework; and design its summary and analysis accordingly. ID is not a stand-alone regulatory mechanism and the Commission must consider the incentives provided to regulated suppliers in meeting the objectives of Part 4 via:
- Input methodologies;
  - Price-quality regulation;
  - Consumer ownership; and
  - Existing information disclosures.

### **Proposed outputs**

29. The Consultation Paper attempts to set out an approach and define information requirements for assessing opex and capex efficiency without providing an indication of how this analysis will be presented, and how it will relate to other information and or analysis to be developed. For example, it is not clear from the Consultation Paper how the Commission intends to present its findings, the information and/or commentary that may be included and how the Commission will draw its conclusions.
30. The Commission needs to be mindful of the potential incentives it may create as a result of its summary and analysis of ID. The implications of cost efficiency analysis are that some suppliers may be deemed by the Commission to be less efficient than others. If these conclusions are incorrect and if suppliers are incentivised to reduce expenditure consistent with the Commission's expectations, then the purpose of Part 4 will not be met.
31. It is reasonable to expect the ID information assessment and analysis to be viewed as identifying triggers for possible further consideration.

32. The Commission's assessment of AMP compliance is a good example of the influence the Commission has on EDB behaviour. Typically following AMP compliance assessments, EDBs have sought to address the issues raised by the Commission. Sometimes the issues raised were not significant or relevant to the business. However the issues were addressed simply to avoid further assessments of deficient compliance. Other times the issues raised were conceptual (such as identifying non network solutions to development options) and the additional analysis required to demonstrate compliance resulted in little, if any, real impact on the development plan.

### **Recommendation**

33. Accordingly the ENA submits that the Commission needs to be very careful about how it develops and presents its proposed cost efficiency analysis, to ensure the incentives it will create are not contrary to the Purpose Statement, particularly in respect of the requirements to ensure sufficient incentives to invest and innovate and meet consumer demands.

## **5. Implementation Principles**

34. The Consultation Paper does not adequately set out implementation criteria which, when combined with the objectives discussed above, would help to define its summary and analysis. Accordingly, there are no criteria against which to consider alternatives, or define the scope or range of information required. There is an infinite range of information about EDB performance which could be collected and assessed, with unlimited resources. The challenge for the Commission is to determine the information which is of most importance and relevance to the purpose of ID while assessing the availability of that information and the potential costs of collecting and analysing it.
35. As suppliers and consumers must fund the ID regime including the Commission's summary and analysis, it would be useful if the Commission provided its budgets for this project and the rationale for the budget. Currently we have few points of reference against which to assess the reasonableness of the scope of the proposal. We note that the ID requirements developed for airport services, which are subject to the same requirements set out in section 53 of Part 4, are considerably less detailed than those proposed for EDBs and GPBs should the capex and opex efficiency proposals be implemented. It is difficult to reconcile these disparate approaches for the two sectors.
36. We understand the proposal has been to some extent influenced by the UK electricity distribution price control review process. Similar reviews are undertaken in Australia and cost benchmarking forms part of those processes. However as the purpose of ID is different to price control, we would expect the scope of information collected and the level of analysis undertaken to be less detailed for a ID monitoring regime than a price control regime.

37. One point of reference available to us is the CPP IM information requirements. As a CPP requires pre approval of asset management opex, capex and service levels, it is more similar to the UK and Australian price control regimes. Hence we would expect the level of detail and analysis undertaken for a CPP would be more comparable with the information requirements in these other jurisdictions. Accordingly we would expect the ID information requirements and analysis to be less detailed than those required for CPPs.
38. This suggests that while the international experience provides examples of where electricity distribution cost benchmarking has been applied in practice for the purpose of price control, it does not necessarily provide the appropriate basis on which to develop the Commission's ID summary and analysis role. We also note that there is an absence of *ex post* review studies that assess the correlation of the benchmarking findings to subsequent changes in performance.
39. The Commission has previously acknowledged that ID is the most light-handed regulatory instrument available under Part 4 and that it is mindful of the need to implement a cost-efficient regime.
40. The 2009 Discussion Paper<sup>3</sup> set out the following implementation principles for information disclosure: cost-effectiveness; consistency; transparency; and flexibility. Discussion of these principles is absent from the Consultation Paper.
41. We discuss each of these criteria in the context of summary and analysis below.

### **Cost effectiveness**

42. The existing ID requirements already impose significant compliance costs on EDBs. Any new information that must be created and manipulated to meet the Commission's specifications will add further cost to EDBs. Such costs need to be assessed against a clear and quantifiable benefit and compared to the net benefit of alternative approaches. The ENA submits that the Commission has an obligation to gather no more information than that which is sufficient to meet the statutory purpose of ID, in the most cost effective manner. Where alternatives exist that satisfy the legislative requirements, the most cost effective arrangement should be selected.
43. The proposed comparative analysis has the potential to be extremely costly for both EDBs and the Commission. A considerable amount of new information may be required to facilitate the proposed analysis (for example, the proposal to disclose unit costs and cost driver information for capex). Additional templates and standardisation are also proposed. The Paper considers that all the

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<sup>3</sup> *Commerce Commission, Information Disclosure Discussion Paper, 29 July 2009*

information that may be required should be retained by businesses in any event. This fails to consider how useful the assumed information will be to each business and the associated costs of standardisation and manipulation.

44. Importantly the operating environments of EDBs in New Zealand vary widely. They are generally significantly smaller than similar businesses in Australia and the UK and often have significantly different characteristics (e.g., urban/rural mix, environmental conditions) that are not averaged out within a larger scaled business. While the Commission may have a view on the information businesses require to effectively manage their networks, the manner in which that information is collated and communicated within EDBs varies and may not be retained in quantitative databases.
45. In our view, the most cost effective approach is for the Commission to fully consider the information that is already disclosed by EDBs and to apply this to its performance analysis in the first instance. This depth and breadth of analysis can then be modified over time as required, in response to any concerns or issues which may be raised by the analysis.
46. In particular we note that AMPs include considerable information about an EDB's assets, asset management objectives, life cycle management and development plans. It is necessary to understand these in order to make assessments about capex and opex efficiency. We are concerned that the cost efficiency proposals which are largely based on quantitative analysis will attempt to replicate the AMPs, without making adequate consideration of the explanatory information which already exists in those documents.

## **Consistency**

47. Consistency is important in order to minimise unnecessary cost resulting from change. It is also important in order to provide a robust data series in which to facilitate time-series analysis. In our view, inadequate consideration of existing disclosures has been made, and further consideration should be given to refinements to existing disclosures rather than introducing wholesale changes.
48. Another important consideration is consistency with the IMs. In developing ID IMs and CPP IMs, consideration has already been given to cost categories and information requirements. The level of prescription was consulted on for the ID IMs, and an approach agreed upon which was deemed to be cost effective whilst meeting the objectives of ID. This allowed businesses some flexibility in meeting the cost allocation IM in a manner consistent with the way they manage their costs and their own business structures. This same principle should be applied to all ID information.
49. For CPPs, a full set of data templates was developed which cover cost, service and asset categories, however a certain amount of flexibility was retained in recognition of compliance cost and the business specific drivers for forecast asset management expenditure. It is important that the information developed

for ID is not inconsistent with these requirements, otherwise businesses will be required to run duplicate information systems if they envisage they will apply for a CPP. We anticipate the CPP requirements should be more detailed than those required for ID, but able to be aggregated into ID requirements. CPP proposals must include five years of actual (current period) data, two years of assessment (forecast period) data and five years of regulatory (forecast period) data. These need to be presented in a consistent format over time. It will be unhelpful if ID requirements disrupt this time series for EDBs seeking a CPP.

### **Transparency**

50. Transparency ensures sufficient detail is available to interested parties in order for them to understand an individual EDB's performance against Part 4. As stated in the 2009 Discussion Paper this requires:

- An explanation of the rationale for including certain indicators; and
- Information to be disclosed in a way that is easily understood by interested persons.<sup>4</sup>

### **Flexibility**

51. The Consultation Paper proposes standardisation of information may be necessary in order to facilitate the proposed opex and capex efficiency analysis. However, as stated in the Commission's 2009 Discussion Paper there must be flexibility for regulated entities to disclose a fair reflection of their performance.<sup>5</sup> While the Commission may have a view on the information EDBs require to manage their businesses, standardisation not only adds implementation costs, it may also incorrectly represent a supplier's business or performance. This is the advantage of the AMPs which allow businesses to explain their asset management plans, policies and procedures in a format which adequately reflects their own business. AMPs need to retain sufficient flexibility to be useful to regulated suppliers.

### **Recommendation**

52. Accordingly the ENA submits that before the Commission proceeds with its cost efficiency proposals it assesses these proposals, and potential alternatives against the following implementation criteria:

- Cost effectiveness;

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<sup>4</sup> Supra n3, paragraph 82

<sup>5</sup> Supra n3, paragraph 81

- Consistency;
- Transparency; and
- Flexibility.

## 6. Proposed Comparative Performance Analysis

53. Notwithstanding the preceding comments, and the ENA's proposed alternative approach outlined above, we have considered the Commission's proposed comparative performance methodology and have highlighted a number of issues for consideration below.
54. The following factors influence an EDB's opex and capex, and thus are relevant to any assessment of expenditure efficiency.
- Opex/capex substitutability - It is difficult to compare EDB opex efficiency in isolation of capex efficiency as the two are substitutable to a certain extent. Maintenance can be reduced by investment in more resilient assets or network designs. There is a potential lag between the two in that capex decisions made now are likely to affect operating expenditure in the future. Indeed, historical asset management decisions are likely to affect current maintenance expenditure, making it difficult to assess the impact of the current regulatory regime on current costs. The two expenditure types are therefore only comparable in the long-run, over the life of the asset.
  - Influence of past decisions – current network managers are to some extent constrained by past decisions, not just the level of investment undertaken historically but network design and service commitments. Short term assessments are therefore not relevant and have limited value.
  - Influence of service performance –it is not appropriate when comparing suppliers, or performance over time to ignore the quality of the services delivered. There is a cost/service trade-off, but this must be viewed in the longer term as decisions made now, will have implications over the remainder of an asset's life.
  - Diversity between 29 EDBs – The scale of businesses in New Zealand is fundamentally different to that in the UK and Australia where we understand the proposed approach has previously been implemented. If the proposed model is to be implemented successfully, it will need to normalise for all of the external factors which influence the performance of 29 EDBs. We question whether this is achievable, and as a result

whether incorrect conclusions will be made as to the residual, unexplained, differences in performance. This approach has the potential to tie up considerable resource within regulated suppliers in order to explain company specific factors.

- Unexplained model diversity is not inefficiency – model specification is of paramount importance if the proposed approach is to be entirely quantitative. It is most likely that unexplained differences in performance will be deemed to represent relative efficiency. However, what they will actually represent will be unexplained differences in performance.
- Previous regulatory benchmarking has had mixed results. We note that the benchmarking of EDB performance undertaken by the Commission during the Part 4A thresholds regime (using the multi-lateral total factor productivity approach) was difficult, generated results which were counter-intuitive and not stable over time due to model specification issues. Ultimately benchmarking was excluded from use for price-quality regulation under Part 4.
- International comparison is not permitted or justified under Part 4 and involves additional complexity. The ENA does not support the use of international comparisons of cost efficiency. We note that the section 53B(2)(b) summary and analysis role is to promote greater understanding of the relative performance of regulated suppliers to which ID applies. Given the purpose of ID is to assess performance against the Part 4 purpose statement we do not believe it is reasonable to compare performance with entities which are not subject to Part 4. In addition we note that cross border comparisons require complex adjustments to be made for differences in purchasing power, regulation, tax, accounting differences, industry structure etc. The fact that foreign jurisdictions are less familiar to both the Commission and EDBs also increases the risk of misinterpretation of results because local suppliers are less able to explain differences in costs when compared with foreign suppliers and foreign suppliers are not available to provide the required clarification of their own costs.
- Sub company comparisons are not supported – There are very limited instances where sub company comparisons may be useful in the context of the proposals. Where networks are contiguous and have common ownership, then we submit sub company comparisons for the purpose of ID should not be made.

### **Opex analysis**

55. It is proposed that regression analysis is used to identify the comparative opex efficiency of EDBs. This analysis will seek to explain differences in cost between EDBs. Any difference in cost that cannot be explained by the model

will almost certainly reflect mis-specification of the regression model or input data deficiencies. As we note above, it has not been proven that models of this kind are accurate predictors of inefficiency, as there appear to be no *ex post* studies comparing the predicted scope of operating efficiency improvements with subsequent changes in performance.

56. The specification of the regression model is likely to be the most difficult and controversial aspect of the proposed approach, given mis-specification can be mis-interpreted as inefficiency. Thus the Consultation Paper attempts to define the information required to accurately specify a regression model. It is not clear to what extent the Commission has tested the existing information disclosure data set (for EDBs) for this purpose. As stated previously, we submit that the Commission should firstly determine the outputs it requires to assess performance against the purpose statement before considering the information already available to it for this purpose.
57. We note that the Consultation Paper recognises that the choice of comparator will be largely determined by data availability and quality. It is proposed to use current year data and potentially previous years' data. We suggest that the existing dataset should be used in the first instance to determine whether meaningful analysis can be undertaken. We believe that the existing dataset sets out a range of network characteristics and expenditure categories which provide a useful starting point to assess business performance. This would assist with the trend analysis for each EDB. We note that consistency in interpreting the current requirements may be improved with further explanation for some of the definitions in the current ID requirements.
58. Further comments on the proposed opex analysis are included in Appendix 1 which includes responses to the questions included in the Consultation Paper.

### **Capex analysis**

59. The Consultation Paper proposes an approach which appears largely based on the UK electricity distribution price reset process, which included efficiency assessments of capex plans by independently assessing the forecast level of capex activity and the forecast cost of each capex activity.
60. The proposed analytical framework appears to be similar to that envisaged for a CPP proposal, as it suggests disaggregating forecast capex by activity, asset levels and unit costs. Indeed paragraph 4.10 suggests that the level of information about forecast capex required for this approach is likely to include:
  - Activity level disaggregation of expenditure (by project and/or major asset);
  - Drivers for each capex activity (quantified for current and forecast periods);

- Physical quantity of each activity proposed (by project and or major asset group); and
  - Unit cost data for standard activities by project and/or major asset group.
61. The Consultation Paper suggests that much of this data is already included in AMPs but it is not standardised. It appears as if the suggestion is for EDBs to break down their AMPs into a series of schedules of expenditure (by category/asset/project) and expenditure drivers (quantities of assets and unit costs) in order for the Commission to derive a database of comparators (numerators and denominators) to be used to compare the AMP capex forecasts.
62. In responding to the proposal, the following observations are relevant:
- Individual network requirements – each EDB’s capex plan is unique to its network, hence inter-company comparisons can only be of limited value.
  - Level of disaggregation – the proposed level of disaggregation is at least as detailed as the CPP proposal information requirements and possibly more so. We do not believe this is consistent with the purpose of ID. The proposals are inappropriately influenced by the UK price control setting process and need to be refined to meet the purpose of ID.
  - Whilst EDB AMPs include a ten year forecast capex plan, the capex plan is not derived from a detailed bottom up schedule of projects and costing other than for the first 12 and possibly 24 months. The medium term forecast does reflect a detailed work programme. As AMPs are updated annually, the capex plans are refined and updated each year, and the detailed work programme is rolled forward at this time. This is consistent with the ID requirements which set out the expectations for the level of detail to be included in AMPs as follows:
    - A detailed description if projects currently underway or planned for the next twelve months;
    - A summary description of the projects planned for the next four years; and

- A high level description of the projects being considered for the remainder of the AMP planning period.<sup>6</sup>
  - AMP forecasts are presented in current dollar terms. This reflects existing labour and material input costs. As the AMP is rolled forward each year these are updated to reflect changes in market conditions.
  - AMPs forecasts reflect current knowledge about service requirements and customer activity. Again this is updated each year.
  - Imposing standard information requirements on capex planning will be costly. As demonstrated in the existing AMPs, EDBs have a number of different ways in which they view their assets, manage them, and collect and manage asset data. These reflect the operating priorities of each network.
  - Although the Consultation Paper presents the capex proposal as an engineering based assessment, it is not clear where the engineering judgement fits into the proposal. This would appear to be more readily addressed by an engineering assessment of each AMP. The AMPs include the relevant explanations and background information which support the capex plan.
63. Further comments on the proposed capex analysis are included in Appendix 1 which includes responses to the questions included in the Consultation Paper.

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<sup>6</sup> Commerce Commission, Electricity Information Disclosure Handbook, 31 March 2004 (as amended 31 October 2008) , section 4.5.5

## Appendix 1: Response to Questions

*Q.1 How much insight would an assessment of operating expenditure based on NZ comparators alone provide, for EDBs and for GPBs?*

*Q.2 How insightful could international comparators be in assessing EDB and GPB expenditure?*

*Q.3 What companies, countries or datasets should be included in the analysis?*

For EDBs, assessments of performance against the Part 4 Purpose Statement should be made with consideration of information available about those electricity distributors which are also subject to Part 4. It is not relevant to consider the performance of other electricity distributors which are not subject to Part 4, or other businesses which are also not subject to Part 4. Given the purpose of ID is to assess performance in the context of section 52A; we suggest comparison should be limited to those companies which are subject to that. Accordingly we do not support international comparisons. In addition we believe that the 53B(2)(b) requirement for the Commission's summary and analysis to assess relative performance is limited to performance of those suppliers subject to ID.

In this context however, we also do not support comparison between GPBs and EDBs. We believe the markets; sector structure and network performance drivers are sufficiently different to make comparisons between regulated sectors meaningless.

*Q.4 How appropriate are sub-company comparisons of costs?*

*Q.5 How feasible and costly would it be to collect sub-company cost and characteristic data to enable sub-company comparisons?*

We do not support sub company comparisons, other than in the limited circumstances where geographically non contiguous networks may have underlying characteristics which are fundamentally different. This differs to the current requirements for separate disclosures for businesses which are contiguous and which have common ownership but where the ownership and consumer footprints differ.

*Q.6 What factors (outside management control) drive industry wide opex?*

*Q.7 To what extent does the current information disclosure data capture these factors?*

*Q.8 What cost drivers, if any, (outside management control) are unique to your EDB or GPB?*

*Q.9 To what extent does the current information disclosure data capture these factors?*

There are a number of drivers of opex, many of which are currently captured by existing ID. These include:

- Line length, voltage, overhead/underground mix, urban/terrain mix
- Asset condition, age, remaining life, construction type/material, network design
- Demand density, volume density, connection point density, capacity density, energy intensity
- Past investment
- Quality targets
- Regulatory/legislative requirements.

*Q.10 What factors (other than changes in input prices) influence opex over time?*

- As above, plus growth and capex.

*Q.11 To what extent should quality be taken into account when assessing cost efficiency?*

It is not possible to assess asset related costs without assessing asset performance. This is consistent with the 52A Purpose Statement. This is well demonstrated in EDB AMPs.

*Q.12 What level of opex should be assessed? Should the current sub-categories of EDB and GPB opex (e.g. general management, administration and overheads) be separately assessed, should further disaggregated cost data beyond these categories be collected and assessed, or should the analysis focus on total opex only?*

*Q.13 What components of opex should be separately benchmarked?*

It is difficult to comment without understanding what outputs the Commission is planning on generating and the other components of ID which are to be implemented as a result of this review.

The current cost categorisation has not been adequately tested, and should be before any further changes are made. No further disaggregation should be implemented until this has been achieved. It may require further refinement to the definitions which support the current costs, however these have now been implemented in AMPs and EDB budgeting, and they have also been replicated in the CPP and Cost Allocation IMs. We do not support further disaggregation at this stage. If the Commission wishes to further refine the definitions of each category to improve consistency across businesses, we would be happy to assist.

*Q.14 How much insight would external comparisons of common functions provide?*

*Q.15 What functions should be benchmarked and how easily available is cost data at a function-level?*

*Q.16 What industries and operators should be included when benchmarking these functions?*

We do not support comparison with businesses which are not subject to Part 4, or other sectors such as GPBs for the reasons set out above.

*Q.17 Should nature-of-work comparisons be further considered in assessing EDB and GPB opex efficiency? If so, what sectors should be included in the analysis?*

We believe consideration of nature-or-work comparisons is premature for EDBs. Own sector data should be assessed in the first instance, consistent with the purpose of ID, before other forms of analysis should be considered.

*Q.18 To what extent should assessments of historical capex based on direct comparisons be considered as part of summary and analysis?*

*Q.19 What are the material assets and activities that should be included in a capex assessment?*

*Q.20 What are the drivers of activity on these assets?*

*Q.21 How can capex effectiveness be measured?*

*Q.22 How suitable is the proposed approach for assessing capex?*

Although the Consultation Paper sets out a high level approach for assessing capex efficiency, it includes little detail on what the outputs will be and how the Commission will present these outputs and what conclusions it intends to draw from them.

We support the current categories of capex cost as included in the current IDRs and the CPP IM. If the Commission wishes to consider asset categories then we submit it should also use the same categories as those contained in the CPP IM. However we do not believe that information at a level of project or programme (as required for a CPP proposal) is required for the purpose of ID.

Capex forecasts are currently set out in the AMP. They are estimates, and with the exception of the first one or two years do not represent a detailed work programme. They are continually revised, updated and firmed up as the AMPs are rolled forward. This is different to a CPP or the Australian or UK price review process. It is consistent with the operational requirements of EDBs. This limits how much analysis can be performed on AMP capex forecasts. Other than for the first few years they are not generally reflective of detailed bottom up cost estimates.

*Q.23 To what extent do suppliers consider the opex-capex trade-off could distort an assessment of expenditure that is based on separate reviews of opex and capex?*

*Q.24 Which components of expenditure have significant opex-capex trade-offs?*

*Q.25 How should the cost analysis take into account any opex-capex trade-offs?*

It is not appropriate to consider either opex or capex in isolation. The overall level of activity on a network is of most relevance, and the underlying drivers for that activity. Currently this is well demonstrated in each EDB's AMP. In assessing opex levels, capex levels must be considered. Renewals capex and maintenance are directly linked, and the system growth expenditure may have indirect implications for renewals and maintenance, where assets may be replaced or upgraded before end of life. We question whether it is possible to undertake a fully quantitative assessment of capex/opex and caution against this. We believe the AMPs provide the most useful information for assessing capex/opex trade-offs.