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**SUBMISSION ON INFORMATION DISCLOSURE: APPROACHES TO UNDERSTANDING EDB
AND GPB COST EFFICIENCY**

- 1 Orion New Zealand Limited (**Orion**) welcomes the opportunity to comment on the “Information Disclosure: Approaches for understanding EDB and GPB cost efficiency” consultation paper (the **paper**) released by the Commission on 7 October 2011.
- 2 This submission is in two parts:
 - our comments on relevant parts of the paper; and
 - our responses to the Commission’s questions.
- 3 The Electricity Networks Association (ENA) has also submitted on the paper. Orion also supports the conclusions and recommendations in the ENA submission.

General comments

- 4 We do not believe that the Commission’s initial thinking to date, outlined in the paper, on approaches for assessing EDB and GPB efficiency for the purpose of undertaking summary analysis of information disclosed under part 4 of the Commerce Act, is appropriate.
- 5 We do not believe that the comparative benchmarking approach proposed in the paper is required, nor do we believe it will add any useful information that the Commission can summarise and analyse to provide interested parties with a greater understanding of the performance of individual regulated suppliers, their relative performance, and the changes in performance over time (s53B (2)(b)).
- 6 There have been a number of attempts at comparative benchmarking in relation to EDBs, including the Commission’s previous approach under Part 4A that have been



unsuccessful. We believe that the many issues identified in our response to the Commission's questions illustrate why previous attempts at comparative benchmarking have failed and also why this proposal to carry out comparative benchmarking will also fail to achieve its purpose.

Limit information disclosure to no more than necessary

- 7 As we have previously indicated to the Commission,¹ Orion believes that the requirement for non-exempt EDBs to comply with the default price path (DPP) is a higher standard and more onerous than "standard" information disclosure. Regulation of non-exempt EDBs will thus focus more on DPP (or where relevant, CPP) compliance than on the information disclosure regime. Requiring repeated disclosure of the same information but in subtly different formats plainly does not accord with the purpose of Part 4 and the Commission should guard against it.
- 8 We believe that the Commission should limit the information disclosure requirements to no more than that necessary to meet the purpose of the control regime (s 53A). In doing this the Commission should take into account the other disclosed information such as that in the compliance and monitoring statements required under s 53N.
- 9 This information together with an asset management plan (AMP) should form the bulk of any information disclosure regime for non-exempt EDBs.
- 10 For those EDBs that are also subject to DPP regulation s 53N expressly provides for monitoring compliance with price - quality standards:

"For the purpose of monitoring compliance with a price-quality path (whether a default price-quality path or a customised price-quality path under this subpart, or an individual price-quality path under subpart 7), the Commission may, in addition to exercising its powers under section 98, issue a written notice to a regulated supplier requiring it to provide any or all of the following:

- "(a) a written statement that states whether or not the supplier has complied with the price-quality path applying to that supplier:*
- "(b) a report on the written statement referred to in paragraph (a) that is signed by an auditor in accordance with any form specified by the Commission:*
- "(c) sufficient information to enable the Commission to properly determine whether all applicable price-quality paths have been complied with:*
- "(d) a certificate, in the form specified by the Commission and signed by at least one director of the supplier, confirming the truth and accuracy of any information provided under this section."*

- 11 A statement by an EDB under s 53N will necessarily include sufficient information for the Commission to assess DPP compliance (and thus whether an EDB is complying with Part 4). Being a higher and more onerous standard than "standard" information disclosure – regulation of non-exempt EDBs (unlike, for example, airports) will thus focus more on DPP compliance than on the information disclosure regime.

¹ Orion's Submission on Information disclosure September 2009

12 Orion is keen to avoid the current inefficient duplication of information provision that existed under the previous threshold regime where EDBs supplied threshold compliance statements followed by information disclosure statements containing much of the same information.

13 The Commission has previously indicated that default customised price-quality regulation has two purposes²:

the overarching purpose of Part 4 as set out in s 52A; and

the particular purpose set out in s 53K.

14 We consider that the monitoring compliance requirements set out in s 53N particularly s 53N(c) should provide the Commission and other interested parties with sufficient information to assess whether the purpose in s 52A is being met.

15 However, we acknowledge that the Act also requires (s 54) that non-exempt EDBs should also be subject to information disclosure requirements as well as the compliance information required by s 53N. We consider that to the extent that the information provided to the Commission is the same then only one disclosure should be required.

16 The Commission must keep front-of-mind the explicit recognition in s 53K that the DPP regime is intended to provide a relatively low-cost way of regulating suppliers. Requiring repeated disclosure of the same information but in subtly different formats plainly does not accord with s 53K or with the purpose of Part 4 generally.

Endorsement of the ENA's recommended alternative approach

17 As indicated above we endorse the ENA's submission and particularly its recommended alternative approach:

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.

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.

We note that in the immediate term a comparison of individual company performance over time may be more meaningful than sector wide comparative performance. 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.

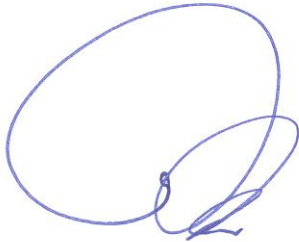
² Paragraph 401 *Regulatory provisions of the Commerce Act 1986 discussion paper 19 December 2008*

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.

Concluding remarks

- 18 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions please contact Graeme Wilson, DDI 03 363 9653, email graeme.wilson@oriongroup.co.nz

Yours sincerely

A handwritten signature in blue ink, consisting of a large, loopy initial 'G' followed by a smaller, more intricate signature.

Graeme Wilson
Management Accountant

Appendix: Responses to the Commission’s questions

<p>Q.1 How much insight would an assessment of operating expenditure based on NZ comparators alone provide, for EDBs and for GPBs?</p>	<p>Our experience has been that the 29 New Zealand EDBs are all different, and consequently any assessment of operating expenditure will be influenced by those differences. The EDBs have a range of:</p> <ul style="list-style-type: none"> • sizes • climatic conditions • overhead/underground mixes • subtransmission/distribution mixes • age profiles • growth profiles • urban/rural • tree management • customer densities • load profiles • reliability targets and trends • cost allocation methodologies • relationships with contractors • corporate structures • alternative sources of energy (eg, reticulated natural gas) • local geography, including ground conditions and the terrain • and other factors <p>all of which somehow have to be meaningfully normalised in order to provide any assessment.</p> <p>For this reason we consider that comparative data:</p> <ul style="list-style-type: none"> • can, at best, provide only broadly indicative information rather than any genuine “truth” • is potentially misleading • will cause an unfortunate focus on what is measured to the detriment of what is not.
<p>Q.2 How insightful could international comparators be in assessing EDB and GPB expenditure?</p>	<p>We took part in some international benchmarking a decade or so ago. Our experience was that considerable additional discussion needed to take place between our managers and the survey company to identify and understand differences. All the differences</p>

	<p>identified in our response to question 1 applied. Further, a lack of commonality about how disclosures were defined definitely didn't help.</p> <p>Other factors to consider include:</p> <ul style="list-style-type: none"> • different business structures – for example, the presence of metering, customer call centres, customer billing, and large and complex information systems at a level not appropriate for the size of NZ EDBs • different engineering – for example, very heavy distribution lines, the presence of subtransmission, radial versus circuit network design structures, the presence of natural gas for heating etc • different regulatory structures • different levels of compliance costs • remuneration differences • scale of construction – much larger projects are typically cheaper on a per metre basis.
<p>Q.3 What companies, countries or datasets should be included in the analysis?</p>	<p>We believe that it is unnecessary to compare EDBs with any overseas countries or other companies, and that in any case such comparisons would not be meaningful.</p>
<p>Q.4 How appropriate are sub-company comparisons of costs?</p>	<p>Any sub-company comparison of costs immediately requires extremely clear definitions about how to allocate common costs and assets.</p> <p>Our experience operating a north island GPB and a south island EDB at the same time was that there were quite clearly some costs and assets which were uniquely attributable to each activity, but definitely some common costs and assets to be assigned on some basis.</p> <p>The greater the integration of the business the less tenable it is to apportion costs and assets as the greater the extent of common use. For example, to create a sub-company analysis of our existing EDB would require the notional apportionment of a significant number of common-use assets and costs.</p> <p>We do not believe that sub-company comparisons will contribute to an improved understanding the industry.</p>

<p>Q.5 How feasible and costly would it be to collect sub-company cost and characteristic data to enable sub-company comparisons?</p>	<p>Further to our response to question 4 above, the greater the level of detail required the greater the cost, and the greater the complexity and likelihood that costs and assets will not be allocated consistently to enable meaningful inter-business comparisons.</p> <p>Some EDBs operate only one network with insignificant other activities; others have extensive involvement in multiple networks (both gas and electricity) and some have extensive involvement in contracting and other activities.</p> <p>EDBs who rely solely on “in-house” operations will have quite different cost structures to those EDBs, such as Orion, who have corporate separation of their contracting activities and use external contractors extensively. In the latter situation various contractor overheads and profit margins are included in network maintenance and capex costs.</p> <p>As analysis becomes more detailed, complexity rises. In turn this leads to a greater level of prescription required within category definitions, confusion over categorisation and increased costs of compliance – for very little benefit.</p>
<p>Q.6 What factors (outside management control) drive industry wide opex?</p>	<p>The factors are many and varied, and include:</p> <ul style="list-style-type: none"> • compliance costs – including health and safety, working in the roads, industry regulation, vegetation management • labour market conditions – including the level of alternative work available for contractors and scarcity of key skills (eg, cable jointers or line mechanics) • exchange rates • pressure to improve reliability of existing networks as well as pressure from rural customers who increasingly seek reliability closer to urban levels, and pressure to improve customer service levels – leading to increased investment in new technologies and higher opex • earthquakes/natural disasters • service levels. For example Orion arranges and pays for ongoing over-boundary maintenance • current state of the network

<p>Q.7 To what extent does the current information disclosure data capture these factors?</p>	<p>The current information disclosure data captures these additional costs within reported opex but makes no allowance for them in understanding trends.</p>
<p>Q.8 What cost drivers, if any, (outside management control) are unique to your EDB or GPB?</p>	<p>All cost drivers impact our company to a lesser or greater extent than our peers – in a unique combination.</p> <p>These factors include:</p> <ul style="list-style-type: none"> • the recent Canterbury earthquakes • climatic conditions (both with respect to one-off events or long-term trends) • overhead/underground mixes, and pressure from local authorities and roading authorities install new reticulation underground and underground existing reticulation • our asset age and condition profiles • our growth profile • our urban/rural mix • extent of required tree management • our customer density • our load profile, driven by winter heating loads and summer irrigation loads • our reliability targets and trends • changes in the contracting market in Christchurch • local geography, including ground conditions and the terrain • a lack of alternative sources of energy (eg, no reticulated natural gas and clean air regulations which severely limit the use of solid fuel burners) • and other factors.
<p>Q.9 To what extent does the current information disclosure data capture these factors?</p>	<p>Some of these factors are included in the current disclosures – overhead and underground mixes and lengths, overhead circuit length by terrain, and a basic measure of overall density.</p>

<p>Q.10 What factors (other than changes in input prices) influence opex over time?</p>	<p>Factors include:</p> <ul style="list-style-type: none"> • 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 – and these often become “tighter” over time as customer requirements change • regulatory/legislative requirements • natural disasters • growth • approach to risk management.
<p>Q.11 To what extent should quality be taken into account when assessing cost efficiency?</p>	<p>Quality and cost are very tightly linked. However, quality is also a function of past investment decisions and the investment cycle, the factors identified in our response to question 1, and customer consultation.</p>
<p>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?</p>	<p>We believe that such sub-comparisons are fraught with difficulties, particularly with regards to definitions, and consequently of no value. In fact, as they raise apparent and false differences between companies based on reported amounts which then require further explanation and analysis, they are actually unhelpful. As noted in our response to question 5, companies structure themselves in different fashions with different cost structures, and even single network EDBs will also have different internal departmental and operational structures from one another.</p>
<p>Q.13 What components of opex should be separately benchmarked?</p>	<p>The disclosure regulations promulgated by the Ministry for Economic Development used two components to analyse opex – direct costs (divided by circuit kilometres) and indirect costs (divided by customer numbers). Even with just two components the “split” varied widely, and we found the only way to compare costs was to take the total cost. Even that is fraught with difficulty as different EDBs may capitalise the same costs/projects differently at the margin. We submit that any analysis should be at a high level.</p>

<p>Q.14 How much insight would external comparisons of common functions provide?</p>	<p>We believe that such comparisons are fraught with difficulties. Companies structure themselves in different fashions, and extreme prescription would be necessary on definitions to attempt to “ring-fence” similar costs.</p> <p>For example:</p> <ul style="list-style-type: none"> • what would be in IT? License costs? SCADA or SCADA support? Support for other control room systems? An accountant who performs systems accounting work? • control and call centre costs will also vary considerably as some EDBs do not have call centres at all and other operate both control and call centres 24 hours a day. <p>Even if costs can be ring-fenced in a similar fashion from EDB to EDB then we doubt that there is any value in preparing the comparison without considerable extra information about the context of the expenditure.</p>
<p>Q.15 What functions should be benchmarked and how easily available is cost data at a function-level?</p>	<p>As above, function level data for Orion will be structured differently from other companies – and rightly so, because that’s what innovation is all about. If any lower-level detail is required it will require a significant level of definition (in which case cost data will have to be re-shaped to match) for, we believe, little benefit.</p>
<p>Q.16 What industries and operators should be included when benchmarking these functions?</p>	<p>There are sufficient EDBs for any benchmarking to take place within the industry without a need for any external comparison.</p>
<p>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?</p>	<p>We concur with the ENA’s view that consideration of nature-of-work comparisons is premature for EDBs. Own sector data should be assessed in the first instance, consistent with the purpose of information disclosure, before other forms of analysis should be considered.</p>
<p>Q.18 To what extent should assessments of historical capex based on direct comparisons be considered as part of summary and analysis?</p>	<p>We agree that the reasons outlined in section 4.2 of the Commission’s paper make any historical review of capex extremely difficult.</p> <p>However, we note:</p> <ul style="list-style-type: none"> • “underinvestment” may actually be about an EDB’s decision to delay capex on a just-in-time basis • high growth on some networks and the availability or unavailability of capacity on the high voltage network may lead to significant expenditure which is step-incremental in nature – eg, building a

	<p>new major substation or a large line or cable project. These necessary expenditure peaks will distort any comparative data.</p> <p>We are also puzzled by the comment in section 4.3 of the Commission's paper which states: <i>comparisons of actual and forecast expenditure at the level of an individual operator may provide additional insight into a supplier's cost efficiency.</i> Surely all such a comparison will provide is a view on the ability of the individual operator to forecast expenditure, and this is a function of (amongst other things) new customer demand and market conditions.</p>
<p>Q.19 What are the material assets and activities that should be included in a capex assessment?</p>	<p>We agree with the ENA's views on capex assessment. <i>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.</i></p> <p><i>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.</i></p> <p><i>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.</i></p>
<p>Q.20 What are the drivers of activity on these assets?</p>	<p>Drivers are many and varied.</p> <p>Some types of work are driven completely by customer requirements, which in turn reflect local and national economic conditions. Such work includes customer connections and new subdivisions and commercial developments.</p> <p>Some types of work are also driven by third parties – notably asset relocations associated with roading projects or underground conversions.</p>

	<p>Some types of work arise as a consequence of:</p> <ul style="list-style-type: none"> • asset age, asset condition and therefore replacement cycles • overall growth on the network which leads to either small or large incremental capex on the network to provide sufficient capacity – which reflects past expenditure and growth trends and the design of the network (ie, how much future capacity was built into the network) • capex associated safety, risk management or quality initiatives. Our experience is that rural customers now seek quality improvements to much closer to urban levels than was the case a decade ago.
<p>Q.21 How can capex effectiveness be measured?</p>	<p>Refer to our response to question 19.</p>
<p>Q.22 How suitable is the proposed approach for assessing capex?</p>	<p>Refer to our response to question 19.</p>
<p>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?</p>	<p>It is not appropriate to consider either opex or capex in isolation, and as noted earlier quality is also a key part of the mix. We agree with the ENA's view that <i>the overall level of activity on a network is of most relevance, and the underlying drivers for that activity.</i></p>
<p>Q.24 Which components of expenditure have significant opex-capex trade-offs?</p>	<p>Renewals/replacement capex and maintenance are most directly linked. Clearly there is an optimum level where an asset is left to be replaced at failure or regularly maintained to extend life and avoid failure, and this will vary from asset to asset and subject to the unique conditions faced by each EDB.</p> <p>Some capex on automation may also reduce opex – eg, the ground fault neutraliser technology.</p> <p>Undergrounding overhead assets is also likely to lead to improved quality and reduced opex.</p> <p>Demand side management expenditure, which may either be capex or opex in nature, may also lead to a significant postponement of capex.</p>
<p>Q.25 How should the cost analysis take into account any opex-capex trade-offs?</p>	<p>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. Like the ENA, we question whether it is possible to undertake a fully</p>

	<p>quantitative assessment of capex/opex and we stress caution against this. We believe the AMPs provide the most useful information for assessing capex/opex trade-offs and the matching quality trade-offs.</p>
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