



**Submission to Commerce Commission on  
Information Disclosure Process and  
Issues Paper**

**9 March 2011**

## Introduction

1. Vector welcomes the opportunity to provide this submission on the Commerce Commission's (**Commission**) consultation paper *Information Disclosure Regulation Electricity Lines Services and Gas Pipelines Services: Process and Issues Paper*, dated 23 February 2011.

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## Value for money

3. Information disclosure is an essential part of the Part 4 regulatory regime and Vector supports a robust and transparent set of information disclosure requirements. However, we are concerned that the Commission's focus appears to be on creating additional requirements and developing an ever-increasing set of information that regulated suppliers need to produce to audited standards. The Commission does not seem to have given any consideration of whether the costs incurred through providing each piece of information are outweighed by the benefits.

4. The Ministry of Economic Development has recently consulted on a Commission request for a very substantial increase in budget for regulatory activities, the costs of which would be passed on to consumers. Vector submits that the Commission would be better placed to avoid a need for such substantial funding increases if it limited its demands on regulated businesses for information, thus reducing costs for both the Commission and suppliers and minimising cost impacts of regulation on consumers.

5. **Vector recommends** that the Commission review whether the information disclosure requirements provide value for money by arranging for an independent cost-benefit analysis. This analysis should be used to ensure that each piece of information does deliver benefits that outweigh both the costs to suppliers in preparing and auditing the information and the costs to the Commission of reviewing the information. This would be in keeping with providing relatively low-cost regulation. This submission suggests two areas in particular where this analysis would be valuable.

### **Comments on the Commission's proposed process**

6. Vector considers that the proposed process to develop final information disclosure requirements is generally reasonable. However, there are three points where we suggest improvements.
7. We suggest that feedback on the Starting Price Adjustment (**SPA**) information request for the purpose of information disclosure should be requested after the final information has been provided to the Commission. The Commission has proposed that the feedback be provided within 3 weeks of the publication of the final information request.
8. However, at that time regulated suppliers will be focusing their efforts on responding to the information request and may not be able to devote much attention to providing feedback. Also, any issues that are identified while responding to the information request will not be captured by this feedback process if they arise after the first three weeks. Providing feedback on the information request after 27 May would enable suppliers to comment on any difficulties they experienced in collecting and reporting the information requested as well as highlighting any auditing issues that may have arisen during the audit process.
9. **Vector recommends** that the deadline for feedback on the final SPA information request is set at 3 June, one week after the information requested will be provided to the Commission.
10. The Commission's proposal appears to propose a one month consultation on the Draft Determination with a short period for cross submissions. This is too short a timeframe for full and detailed consideration of the Draft Determinations. **Vector recommends** a minimum six week consultation for the Draft Determinations plus time for cross submissions. This would be more reasonable and more likely to give respondents adequate time to respond.
11. Finally, the information request relates to electricity only so gas pipeline businesses may be at a disadvantage when it comes to commenting on the suitability of the information request. **Vector recommends** that the Commission provide suppliers of gas pipeline services with an opportunity to provide feedback on their own information request in time to inform the Commission's development of information disclosure requirements for gas pipeline businesses.

## **Comments on consolidation statements and the alignment of regulatory and disclosure years**

### *Consolidation statements are unnecessary*

12. Vector does not believe that the Commission has demonstrated that the benefits of providing consolidation statements are worth the substantial costs involved in reconciling data between disclosure years and financial years and between the two different bases of preparation.
13. It is unnecessary for the Commission to use these consolidation statements to “assess whether the regulatory account comply with the ID requirements”.<sup>1</sup> The regulated statements are audited to ensure their accuracy and the publication of audited information on the regulated businesses provides the required transparency so there should be no question that disclosures comply. The Commission should not attempt to repeat work that is already done by the auditors and paid for by the regulated supplier – such duplication is expensive for all parties and, ultimately, consumers.
14. As a result, there is no identifiable benefit from providing disclosed information about the non-regulated businesses to the Commission. Further it is unlikely that the consolidation statement will be of value to other interested parties given the significant differences between the financial and regulatory financial statements and the resulting complexity of understanding the connection between the two. For example, the deferred tax calculations for regulatory purposes are unusual and few users of financial statements are sufficiently well informed to understand deferred tax even in normal financial statements. A requirement to reconcile the two sets of deferred tax calculations is likely to be time consuming to prepare and to be incomprehensible even for professional users of the statements.

### Costs created by consolidation statements

15. A requirement for regulated suppliers who also provide unregulated services to publicly disclose consolidation statements creates substantial costs, particularly for firms like Vector whose financial years do not align with their disclosure years. These costs would ultimately be borne by consumers. These costs are created for the following reasons:
  - a) If Vector is required to release information about its gas pipeline and unregulated businesses in the electricity distribution disclosures published for the March disclosure year this information will disclose the performance

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<sup>1</sup> Commerce Commission, Information Disclosure Process and Issues Paper, 23 February 2011, paragraph 36.

of the overall Vector group for a period for which Vector does not currently provide the market with information. This creates difficulties for Vector as a listed company as it will then be necessary to operate an investor relations programme around the March year results when they are released to the market to ensure that the results are correctly interpreted. We may, for example, need to provide investors with information to allow them to assess the relevance of the published information to the current financial year performance of Vector (i.e. to determine what portion relates to the nine months in the current financial year and what portion relates to the last quarter of the previous financial year. Vector historically provided quarterly financial results but discontinued this practice as the cost to do so significantly exceeded the benefits.

b) The publication of consolidation statements would be likely to place Vector at a competitive disadvantage, because:

- i. In providing information on Vector's unregulated businesses on a 31 March year end and a 30 June year end Vector will effectively be providing quarterly financial information to the markets. This will have the effect of providing competitors with this information.
- ii. The regulatory and financial statements differ in a number of important respects and these differences will lead to significant costs to reconcile the numbers. For the unregulated businesses this may impose a requirement to keep records on a similar basis to the regulated businesses to allow the comparison. This would require additional processes and systems to be implemented, which creates costs for these unregulated businesses that will not be faced by their competitors.

c) The cost of audit will increase significantly as the auditor will effectively be required to conduct an audit of both the gas pipeline and unregulated businesses of Vector for the period ended 31 March. This will be necessary to confirm that the consolidation statement provided with the electricity regulatory disclosures is correct. This audit would be in addition to the audit of the financial statements at 30 June and of the gas disclosures.

16. The costs referred to above include external costs to support the required work and to conduct the required audits, internal staff time to prepare the disclosures and a significant opportunity cost in senior management and board time being diverted from leading the business to ensuring compliance and supporting the required investor relations programme.

17. **Vector recommends** that the Commission demonstrate, by way of a published independent cost-benefit analysis, that the benefits of consolidation

statements to consumers outweigh the costs to regulated suppliers to provide them and the Commission to analyse them.

#### *Alignment of disclosure and regulatory years*

18. If the Commission decides that, in spite of the costs identified above, consolidation statements should be required, **Vector recommends** that the Commission permit regulated suppliers to provide information disclosure aligned to their own financial years rather than the regulatory year. This would mitigate the costs identified with consolidation statements.
19. The alignment of disclosure and financial reporting will have real benefits in addition to avoiding the costs of a consolidation statement, as described above. These include:
  - a) Significant synergies in both preparation and audit of the financial and regulatory statements could be achieved if the electricity disclosure year aligned with the financial reporting year.
  - b) The significant complexities involved in undertaking cost allocations relating to the same shared costs but to two different year ends would be avoided, reducing cost and improving the reliability and consistency of the allocations.
  - c) It would make it easier to compare the regulatory and financial disclosures as the need to make assumptions and adjustments to cover the three month timing difference would be avoided.
  - d) Vector would no longer be in a position of releasing public information about gas network and unregulated businesses in the electricity distribution disclosures published for the March year that differs from the financial reports published for the June year. This creates difficulties for Vector, as identified above.
20. The Commission has also provided a precedent for setting disclosure years that are aligned to the financial years of the company, rather than imposing a single year across all suppliers. The Commission set the disclosure year for Auckland and Christchurch Airports as the 12 month period ending 30 June, and the disclosure year for Wellington Airport as the 12 month period ending 31 March<sup>2</sup>. This should also be possible for electricity distribution and gas pipeline businesses.
21. The Commission is prevented by section 53P(10) of the Commerce Act 1986 (**the Act**) from using comparative benchmarking between suppliers to set starting prices or rates of change. This makes it less important to the

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<sup>2</sup> Commerce Commission, *Commerce Act (Specified Airport Services Information Disclosure) Determination 2010*, clause 1.4.

effective operation of the Part 4 regulatory regime for all regulated suppliers to have the same disclosure year.

22. The three month difference between disclosure and pricing years should not cause unmanageable difficulties for other regulatory activities:
- a) The data required for price path and quality path reporting could be calculated and reported separately from the disclosure years.
  - b) Time series data should not be impacted by a three month variation in balance date between certain suppliers as the information will still cover a twelve month period and, once the new information disclosure regime is implemented, disclosures by each regulated supplier will be on a consistent basis from that time.
  - c) Comparisons between regulated suppliers using different balance dates will still be valid as all suppliers would be reporting on a twelve month period and the effect of changes in CPI over one quarter will be immaterial.
  - d) For future price resets, if required Vector could produce one year's audited set of regulatory financial statements for the year ending 31 March prior to the price reset. This would still be significantly more efficient than providing consolidation statements each year and having different year ends for differing reporting purposes. If the Commission instead chose to use multiple years' historical financial data to set starting prices from 2015, the impact of the three month variation should be negligible and could be dealt with by a simple calculation to adjust for the 1 April price increase.
23. An apparent alternative may be for Vector to change its financial year to align with the electricity disclosure year. However, Vector and Powerco operate both gas pipeline and electricity network businesses so altering the balance date for financial reporting purposes would not generate significant cost savings as the same issues would then arise in relation to gas pipeline reporting. Changing the financial year would also create some complexity for capital markets as the transition would involve a period of less than twelve months and there would be challenges in changing the tax year. Most listed New Zealand companies report on a June financial year and Vector adopted this date based on market expectations that listed entities report on this basis.

*Other ways to minimise the cost of consolidation statements*

24. If the Commission does go ahead with requiring consolidation statements, **Vector recommends:**
- a) They should be limited to earnings before interest, tax and depreciation. Tax, interest and depreciation are the areas in which the most significant

and complex differences exist between disclosures under financial reporting standards and under the information disclosure requirements exist. Therefore these are the areas in which the cost to prepare information on the unregulated businesses would be highest. In addition, this information is likely to be of the least value to interested parties.

- b) The consolidation statements are kept strictly confidential – the Act does not require this information for interested suppliers, it is for the Commission only and as it relates to unregulated businesses, this information should be kept confidential;
- c) The reconciliation statement should be qualitative – where reconciliation can be discussed in broad terms where high materiality thresholds apply (e.g. suppliers would not be required to discuss any differences of less than \$1m on any line item);
- d) The detail required should be kept to a minimum to keep costs down. There is an obligation in section 53D(2) of the Act that these statements only provide the detail required to meet the purposes of section 53D, so the detail required should not be any more than the minimum necessary.

#### *Further discussion*

- 25. Vector would be happy to meet with the Commission to discuss our concerns regarding this issue and explore ways in which information can be provided that gives the Commission the assurances it requires while avoiding costly and time-consuming efforts to reconcile different publicly disclosed information. We consider that aligning the regulatory reporting and financial reporting years would have significant cost savings for both the industry and the Commission and that these cost savings will ultimately flow to consumers with no material adverse impacts.

#### **Comments on the Commission's other initial views**

##### *Consistency in how information disclosure regulation applies*

- 26. Vector agrees that the disclosure requirements should be very similar between suppliers of gas pipeline services and electricity lines services, subject to necessary modifications to reflect differences in the Input Methodologies and the physical characteristics of the networks.

##### *Timing of first disclosure year under the new requirements*

- 27. Vector notes the Commission's initial view that the first disclosure year under the new requirements should be the 2011/12 disclosure year. As the Commission recognises, if the information disclosure requirements will not be finalised until December 2011 there will be some areas where it may not be possible to provide the required data.

28. It is practical to start collecting information now if the information required is the same as what will be requested in the final SPA information request. Other information that may be required is currently not known and it would be inefficient for regulated businesses to invest in systems and processes to collect data before the information requirements have been determined. This is especially the case for non financial information requirements, which have not yet been specified by the Commission.
29. It is possible that such data will not be available at auditable standards for the 2011/12 disclosure year. Vector welcomes the Commission's willingness to consider transitional provisions for areas that are not covered by the input methodologies. **Vector recommends** that the Commission take a flexible approach to requiring full audit sign-off of the information disclosure requirements in the 2011/12 disclosure year.
30. **Vector also recommends** that the Commission defer the disclosure requirements for the 2010/11 year as the current information disclosure requirements (set in 2008) do not reflect the input methodologies. Vector suggests that the 2010/11 disclosures instead be made under the new information disclosure requirements, once they are set. Again, a flexible approach would be needed to requiring audit sign-off and transitional provisions where relevant information would not be available. Therefore, under this suggestion, the first year to be disclosed under the new requirements would be the 2010/11 disclosure year.

#### *Historical financial information*

31. Vector agrees that the starting price adjustment information request and the information disclosure regulation should be consistent in the types of information which they require. However, as set out in Vector's submission on the draft information request<sup>3</sup>, the way the information request is set out makes it challenging to complete and to audit. In addition, as the Commission has recognised, the financial information requested in that statement does not comprise a complete regulatory income statement and provides insufficient detail to determine the key financial indicators that will influence the ROI calculation of electricity distribution businesses.
32. **Vector recommends** that the Commission consult on the additional financial information that is required during the Discussion Stage consultation, to ensure there consultation on the issue prior to the Commission developing its Draft Determination.

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<sup>3</sup> Vector Ltd., *Submission to Commerce Commission on Draft Information Request and Process Update*, 28 February 2011.

*Gas quality information*

33. Vector agrees that the Commission should consult on quality indicators and quality standards for gas pipeline businesses at the same time.

*Related party transactions*

34. The Commission appears to intend to apply the disclosure requirements of IAS 24 to transactions between regulated business and unregulated businesses. This would be different to the related party transactions we presently disclose in Vector's statutory financial statements, because the statutory accounts disclosure is on an entity basis and that entity basis does not align readily with our regulated businesses and unregulated businesses. As a result, disclosure requirements will be more onerous than Vector's requirements under statutory financial statements and hence will add cost.
35. Vector considers that information on related party transactions is likely to be commercially sensitive so should be kept strictly confidential. It is also likely to be costly so the Commission should conduct and publish an independent cost-benefit analysis to demonstrate that the disclosure of this information would provide net benefits to consumers.

*Transactions between regulated suppliers*

36. Vector considers that the costs of mergers and acquisitions should be included in operational expenditure. The efficiencies achieved through mergers and acquisitions will ultimately benefit consumers of regulated services and it is therefore appropriate for the costs of the mergers and acquisitions to be included in operating costs. This would also be consistent with GAAP.
37. Vector is not opposed to providing information on how the merged or acquiring entity has merged its subsequent disclosures for the enlarged business. Consideration would need to be given to partial network sales and how historical data that has previously been disclosed on a network/aggregated level could be disaggregated to meet the Commission's requirements. However, this must be done in a cost-effective way.

*Asset management plans*

38. Vector agrees that existing AMP requirements provide a sound basis for the electricity distribution business AMP requirements under Part 4. Vector also agrees that it would be appropriate for suppliers of gas pipeline services to develop AMPs and that the electricity distribution AMPs should be the starting point for developing the gas pipeline AMPs.

*Contract disclosures*

39. Vector supports a review of the gas and electricity contract disclosure requirements. The current requirements are outdated and unnecessarily onerous. They also subject regulated businesses to commercial risks due to the requirements to disclose commercially sensitive and confidential information. **Vector recommends** these disclosures are kept strictly confidential, if they are required at all.
40. At present, we are required to make contract disclosures continuously, as new contracts are entered into. This creates a considerable compliance burden due to the large volume of contracts entered into across the regulated electricity and gas businesses. **Vector recommends** that such disclosures are made at regular intervals, rather than continuously (we suggest annual disclosures of contracts at the same time as the full information disclosures).