



**Submission on**

**Regulation of Electricity Lines Businesses**

**Review of the Information Disclosure  
Regime Discussion Paper**

**Issued by the Commerce Commission  
24 December 2004**

25 February 2005

## Key points

### ***Introduction***

Orion welcomes this opportunity to provide feedback on the objectives, principles and implementation of the information disclosure regime applying to electricity lines businesses (lines businesses) under subpart 3 of Part 4A of the Commerce Act 1986 (the Act) and the Commerce Commission's (the Commission's) preliminary views as contained in its discussion paper.<sup>1</sup>

Overall, we support the Commission's objective to undertake a full review of the current Disclosure Requirements, beginning from first principles, in order to bring these into line with the statutory purpose for the information disclosure regime of Part 4A, which differs from that under the revoked Electricity (Information Disclosure) Regulations 1999.

However, it is our view that the Commission's process would benefit from focusing to a greater extent on the way in which the Disclosure Requirements can meet their objective, namely by bolstering the effectiveness of the targeted control regime. Monitoring without consequence is generally accepted as being ineffective. To the extent that the disclosure regime provides information that is outside the bounds of the Commission's consideration in the thresholds regime, such information will essentially be superfluous. We elaborate on this in section (a) below.

The review of the disclosure regime also provides the Commission with the opportunity to correct various shortcomings in the existing Disclosure Requirements, which have been costly to prepare and have detracted from the usefulness of the collated data. Orion's views as to the particular aspects that require attention are outlined in section (b) below.

While we agree with many of the Commission's proposals, there are certain aspects that we do not support, largely because they would add compliance costs without improving the ability of the regime to meet its objective. We discuss these points in section (c).

Appendix 1 sets out our responses to the specific questions the Commission has posed throughout the discussion paper.

### **(a) Objectives and principles**

The provisions of Part 4A establish the two related regimes under which lines business are regulated: the information disclosure regime; and the targeted control regime. These regimes share the common purpose of promoting the efficient operation of markets directly related to electricity distribution and transmission services but seek to achieve this objective through distinct means.

Although the two regimes achieve the common purpose through different means, they are not independent of one-another:

- the information disclosure regime provides valuable support to the targeted control regime by increasing the risk that unacceptable behaviour will be caught; and
- the targeted control regime provides a framework against which the disclosed information can be assessed.

---

<sup>1</sup> *Regulation of Electricity Lines Businesses Review of the Information Disclosure Regime Discussion Paper*

Monitoring a firm's behaviour without any threat of consequence would be ineffective in encouraging that firm to behave in the desired way. The disclosure regime does not have any 'teeth' in a stand-alone sense. Its 'bite' comes from its ability to enhance the effectiveness of the targeted control regime.

We recognise that the Commission's focus to ensure that the disclosure regime will provide information on allocative, productive and dynamic efficiency is consistent with the principles underlying the targeted control regime. However, the Commission's purpose may be better served by focussing directly on the information that matches its requirements to:

- establish the thresholds;
- monitor compliance against the thresholds; and
- carry out post-breach investigations into the desirability of control.

The Commission, through the targeted control regime, has set out its expectations for the performance, both financial and non-financial, of lines businesses and has indicated how it will assess behaviour in the context of a post-breach inquiry. In doing so, it has established the bounds within which firms can operate without risking the imposition of control. Information that is extraneous to these processes, while potentially interesting, will not improve the effectiveness of the regime.

Recognition of this interdependence provides a stronger and more compelling framework for the Commission's development of the revised disclosure regime.

However, we also note that comparative monitoring of company performance is extremely difficult to perform in an absolute sense, whether company to company, or a single company over time. Although the efficient new entrant test is of primary importance, assuming the new entrant operates in a "best of the best of the best" manner is not appropriate.

Finally, in considering allocative efficiency it is critical to ensure that prices are not set at a level which discourages further investment and innovation by a lines company, but, using the avoided cost allocation methodology, are set at a level which models the costs and revenues faced by the average efficient new competitor and provides the good prospect for an investor of achieving cost recovery, plus a surplus.

**(b) Amending existing shortcomings**

At this point the Commission also has the opportunity to make adjustments to correct for the recognised shortcomings in the existing Disclosure Requirements. In our view, it would be most useful to remedy the following:

- the existing requirements include a number of measures that are simply not relevant to assessing lines businesses' performance within the framework the Commission has developed, such as ROE and ROF;
- the inconsistencies between how some measures are reported under the information requirements and how the Commission estimates them in the context of the targeted control regime, such as the ROI;
- the inconsistencies between the way companies allocate costs, reducing the ability to make meaningful comparisons;
- the allowance for reporting approaches that reduce the comparability between firms, such as the treatment of rebates;

- the exclusion of certain assets, such as easements, works under construction, and reasonable cash holdings from the regulatory asset base;
- the lack of clarity about the average efficient new competitor test, and its implications for ODV/ODRC;
- the inconsistencies between GAAP and the Disclosure Requirements that lead to confusing or misleading results, such as the treatment of differences between purchase price and ODV; and
- the provisions for the disclosure of transfer payments to related parties are currently unsatisfactory and, in many cases, unnecessary.

Our views on how the Commission could remedy these issues are set out in Appendix 1.

**(c) Concerns with the Commission's proposed revisions**

While we concur with much of the Commission's *Discussion Paper*, we do have concerns about the directions the Commission seems to be heading in some areas. In short, we are concerned that the Commission may be tempted to ask for more information that would be "useful", some of which would be costly for lines businesses to produce. In considering the level and type of information that meets its implementation principle of "relevance", a tighter focus on the role of the disclosure regime in supporting the targeted control regime would be useful. In short, if an item of information does not relate to the Commission's actions under the threshold regime, it is effectively redundant.

It is our view that the following would be costly to produce without improving the ability of the regime to meet its objective:

- disclosure of complete statutory tax information that would allow for reconciliations between regulatory and statutory accounts – this would add considerable complexity to the disclosed information without informing as to the logic behind the split and is unnecessary given the role of the auditor;
- disclosure of a reconciliation between statutory financial statements and regulatory financial statements
- separate information for non-contiguous networks – such information may be costly to produce if the firm's accounts and systems are not set up in this way, furthermore, it risks setting a dangerous precedent, since customers within distinct but contiguous centres could argue that they have just as much right to the provision of separated information
- continued preparation of GAAP-complaint financial statements, for which the prime use is only as a component of the ROI calculation. This is made considerably more complex in the existing environment as different line companies are at different stages in adopting the new international financial reporting standards; and
- expanded analysis regarding labour and materials disclosures for construction and maintenance activities – firms, such as Orion, who largely outsource such activities would not have ready access to such information.

Again, these points are elaborated upon in Appendix 1.

# APPENDIX 1

## Questions and responses

**1 Historical context:** Are there other aspects of the history of the information disclosure regime that should be taken into account in the revised regime? How should these influence the revised regime?

The historical context should not be entirely ignored in developing the information disclosure regime for the current regulatory environment, as it is generally useful to have series of data that are consistent over time for the purposes of ongoing analysis. To the extent practicable, then, it is preferable to maintain existing requirements. However, over-riding this is the importance that the revised disclosure requirements provide information that is meaningful within the existing regulatory environment and consistent across businesses.

We recognise that it is not necessary for the information disclosure regime to provide all the information the Commission requires to assess businesses' performance against the thresholds, at the time of resetting thresholds and in the context of post-breach inquiries.

However, for the disclosure regime to strengthen the incentive on businesses to adhere to the objectives of Part 4A it must increase the likelihood that the Commission would recognise both breaches of the thresholds and behaviour that should result in control being declared. It is our view that this principle should drive the design of the revised disclosure regime rather than its history.

Historically, there were a number of important changes between the 1994 regulations and handbook etc, and the 1999 equivalents. The 1994 framework provided an extensive list of non-mandatory allocation bases for expenses, revenues, assets, and liabilities – many of which were completely unprincipled. The adoption of the mandatory avoidable cost allocation methodology (MACAM) in 1999 provided a sound basis for cost allocations, supported by a continued reference to the efficient new entrant test.

Further clarification at that time, such as the exclusion of metering assets and costs, provided a framework where meaningful comparative information could also be provided.

However, the regulations in 1999 required extensive additional disclosures, a number of which are confused, contradictory and/or meaningless. Refer to our response to question 11 for further details.

In moving forward, we support:

- clear and appropriately-principled methodologies
- the disclosure of information limited to that which would assist the Commission to recognise and interpret breaches of the thresholds, and
- a reduction in the extent of minor prescriptive disclosures.

**2 Statutory framework:** What comments do you have on the Commission's analysis of the statutory framework for the information disclosure regime under subpart 3 of Part 4A?

We have no comment on the Commission's analysis.

**3 Electricity Commission:** What synergies exist in relation to information disclosure requirements by the Commerce Commission and the Electricity Commission that can and should be addressed in the course of revising the information disclosure regime?

Currently, there are no synergies between information disclosure requirements by the Commerce Commission and the Electricity Commission. As far as we are aware, with only one exception, the Electricity Commission has not imposed any information disclosure requirements.

We note the exception that relates to disclosure of low fixed charge “tariff” options and also a similar situation with the Ministry of Economic Development’s long running quarterly/annual survey of average domestic/commercial line charges. These information disclosure requirements are not duplicated within the Commerce Commission’s disclosure requirements. In our view, they should remain separate because they do not relate to the purpose under Part 4A; they do not relate to the regulatory threshold and control regime.

Separately, we suggest that the “Electricity Enterprise Statistics” disclosures under the “Electricity (Statistics) Regulations 1996”, as they apply to electricity transmitters or distributors, should be discontinued. Largely the same set of information is already disclosed under the Commission’s disclosure requirements and, with minor enhancements, the entire set of information can be incorporated.

We also note that the Electricity Commission has some responsibilities to review arrangements for distribution pricing and contractual agreements between lines businesses and retailers and/or consumers. While the outcome will have some effect on pricing and agreements, which must be disclosed, we consider that it is still appropriate for the Commerce Commission to stipulate the information disclosure requirements because they must strictly relate to the purpose under Part 4A.

**4 Information needs:** Please identify your needs as a user of disclosed information that are relevant to the objectives and principles proposed by the Commission. It will be particularly helpful if you can give the Commission an idea of the value of this information to your organisation or the parties that you represent and the relative importance of your different requirements. What level of information reconciliation and disaggregation is appropriate, given the potential for increased compliance costs with greater scope?

We use disclosed information to perform high level comparisons and analysis of our reliability and network performance, level of returns, prices, and expenses against other lines businesses.

However, we are of the view that given the variety of different lines businesses, and variations due to such things as:

- climate
- customer mix (large, rural, urban, holiday homes, irrigation etc)
- geography
- customer density
- level of undergrounding
- level of growth
- the concentration of growth within the region
- age profile of the network
- ownership structures
- tax status (eg, customer rebates or discounts)
- the existence of alternatives, such as reticulated natural gas or LPG, or coal
- the existence or otherwise of clean air zones
- traffic density
- local construction costs

and a wide number of similar factors, it is not possible to definitively benchmark or “rank” performance.

Further, extensive detailed prescriptive disclosures on line items such as labour costs, marketing etc are of limited use. We do not believe that extensive additional disclosures will materially improve the usefulness.

Disaggregation is not necessary, and in some cases may be counterproductive. In order to encourage synergies of scale or scope, businesses should be encouraged to undertake mergers and acquisitions. This would be assisted if the resulting efficiency gains are permitted to be retained by the company for a reasonable period. Requiring extensive analysis in a manner which is no longer relevant post-merger is not productive.

**5 Objectives and principles:** What views do you have on the Commission's statement of the objectives of information disclosure? What comments do you have on the design and implementation principles that the Commission has identified?

The Commission has based its statement of the objectives of information disclosure on the purpose statement of subpart 3 of Part 4A, which is to:<sup>1</sup>

*"... 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."*

The Commission has then proceeded to consider the objectives of the information, and the consequent information requirements, according to the promotion of allocative, productive and dynamic efficiency.

In our view, the main opportunity for the disclosure requirements to promote efficiency would be through (1) strengthening the threat of control (where desirable) should a business breach either the price or quality thresholds, or (2) informing the Commission and interested parties in regard to resetting the appropriate thresholds for the next regulatory period. Additional information that does not enlighten interested parties on these issues is likely to be of limited interest, since it will have no bearing on how the Commission assesses business behaviour and therefore no bearing on future behaviour.

Therefore the disclosure regime should provide information that informs the Commission, and other interested parties, as to:

- lines businesses' adherence to the price thresholds;
- lines businesses' adherence to the quality thresholds;
- whether or not the Commission is likely to declare control in the event of a review following a threshold breach; and
- how the Commission may view businesses' performance at the time of the next threshold review/reset.

If the threshold regime and the Commission's approach to post-breach reviews are consistent with promoting efficiency in the sector, then a complementary information disclosure regime should provide the best opportunity for strengthening these other elements of the regime and

---

<sup>1</sup> section 57T

meeting the purpose of the disclosure requirements. While the Commission's objectives of formulating the disclosure regime around the principles of allocative, productive and dynamic efficiency indicators is likely to result in largely similar information requirements, it provides little guidance in determining which information is most relevant in the current context.

In line with the objectives it has identified, the Commission has proposed five implementation principles, namely that the information disclosure requirements be:

- transparent;
- relevant and understandable;
- consistent and accurate;
- cost effective; and
- timely.

While we agree that the principles the Commission has identified are important, how the Commission chooses to interpret and apply them will be critical to the performance of the disclosure requirements. For example, how will the Commission determine what information is relevant and understandable? We also note that the Commission has recognised there may need to be tradeoffs between the principles of consistency and accuracy – how will these be managed?

Furthermore, is the Commission concerned with consistency between lines businesses, over time or between the disclosure requirements and the threshold and control elements of the regulatory regime?

In our view, the implementation principles could be more carefully specified such that they met the objectives outlined above:

**Relevant** - the disclosed information should be relevant to assessing businesses performance (1) against the price and quality thresholds (2) in the event of a threshold breach and (3) in the context of threshold reviews/resets. In this way, the disclosed information would inform the public as to the businesses' performance and likely future direction as well as encourage businesses to conform to the requirements of the regime.

**Transparent** - the disclosed information should be in a form such that it enables interested parties to readily assess lines businesses' adherence to the thresholds. It should also inform interested parties on those indicators the Commission is likely to take into account when assessing whether or not to declare control in the event of a post-breach inquiry. This will require that the information and any analysis of the information be presented in a way that is readily understandable.

**Consistent** - the disclosed information should be consistent with the information requirements under the threshold and control elements of the regulatory regime. Furthermore, there should be a high level of consistency between businesses to allow for cross-company comparisons. This will require a certain level of specificity in the way in which the Commission sets out the information requirements.

**Accurate** - the disclosed information should be derived from businesses' audited accounts or otherwise verifiable sources, and could be audited.

**Cost effective** - the disclosure regime should achieve its objectives at a reasonable compliance cost.

**Timely** - the information and its analysis should be able to be provided by businesses within a specified period which the Commission considers makes it "fit for purpose".

The overall effectiveness will be enhanced, in our view, if the Commission's requirements for information in relation to thresholds and control can be largely met through the disclosure regime.

**6 Role of disclosed financial information:**

What do you perceive to be the primary role of disclosed financial information in future? What information is of most value in fulfilling that role?

We believe that the primary roles of disclosed financial information are:

- as an input to the calculation of a regulatory return, and
- disclosure of specific required information.

We have not found the preparation and publication of financial statements by other lines businesses has assisted in our evaluation of relative performance. If specific disclosures are required, it is possible for the disclosures to be made outside a full set of financial statements.

**7 Degree of prescription:** How prescriptive do you consider the information disclosure requirements need to be? What aspects of the requirements particularly warrant tight prescription? What should be the relationship between prescription under the Information Disclosure Requirements, and existing requirements and guidelines, including GAAP?

As outlined in our response to question 6, we believe that lines business financial statements are not an essential component of the disclosure requirements.

We recommend that specific required information be made available in a standard template.

Whether a template approach is adopted or full GAAP-compliant financial statements continue to be mandated, information provided should be consistent (not necessarily fully compliant, for example see our recommendation on the treatment of tax in question 10 below) with GAAP principles, and could continue to be audited. As noted in our response to questions 10-13, we believe that the current detailed prescriptions are significantly more detailed than necessary, with some disclosures unnecessary and confusing. In a number of cases, despite attempts at prescription, excessive detail has led to results which are not comparable. For example, the calculation of the existing indirect cost per customer and direct cost per circuit km, has led to a number of different approaches from lines businesses as to how they categorise costs into "direct" and "indirect" – both between each other and over time. Accordingly, we believe it is far more appropriate to look at "total costs" per customer etc – this avoids this unnecessary and arbitrary problem.

Compliance with a guiding principle, such as ACAM, is also important for preparers, auditors and users of the disclosures.

**8 Projections:** To what extent is prospective data useful? What concerns does the disclosure of projections raise in respect of commercially sensitive information?

Projections are currently made available in asset management plans. Our experience is that even in the relatively near future, responding to customer demands and the availability or otherwise of specialist skills requires investment and maintenance plans to change.

We have concerns that any other projected information provided will be so heavily caveated in terms of conservative assumptions that it is unlikely to have any predictive value.

The suggestion in paragraphs 163-165 of increased disclosure of projections, and then a subsequent post-event reconciliation performed of variations, moves from industry governance into a level of financial detail which we believe would only be appropriate in the event of a significant breach of the existing thresholds. In addition, under the current cpi-x regime, there is little opportunity for businesses to significantly increase the base level of profitability of their lines businesses.

Lines companies with businesses which operate in more than one sector will also have to perform significantly more analysis, some of which is likely to be commercially sensitive.

We also note that although the Commission's paper uses the word "projections." However, FRS-29<sup>2</sup> defines a projection as:

*"prospective financial information prepared on the basis of one or more hypothetical but realistic assumptions, (or "what-if" scenarios), that reflect possible courses of action for the reporting periods concerned as at the date that the information is prepared"*

and defines a forecast as:

*"prospective financial information prepared on the basis of assumptions as to future events that the governing body reasonably expects to occur associated with the actions the governing body reasonably expects to take as at the date that the information is prepared (best-estimate assumptions)"*

The commentary then notes that:

*"Forecasts reflect the most probable outcome while projections reflect a range of possible outcomes. The date that the information is prepared is the date when the prospective financial information is approved by the governing body of the entity reporting, or otherwise authorised, for issue."*

We seek clarification as to exactly what the Commission intends.

**9 Cost allocation:** Do you consider that there is a need for greater prescription of cost allocation methods? Bearing in mind the Commission's stance that common costs should not be double-counted, and that they should be allocated in consistent and transparent ways, what suggestions do you have for further prescribing the allocation methods, particularly in multi-utilities or lines businesses with significant contestable business activities?

Economic efficiency requires cost allocation methodologies that allocate:

- no less than the avoidable cost to any business unit; and
- no more than the standalone cost to any business unit.

In addition, efficiency requires that the common costs allocated to any *combination* of business units be no greater than the combined standalone costs. Aside from these bounds, economic theory does not provide a single unambiguous correct allocation mechanism. The closest one can get is to use Ramsey pricing principles to allocate joint or common costs, but this would be extremely difficult to implement in the current context.

---

<sup>2</sup> Financial Reporting Standard 29 – Prospective financial information, paragraphs 4.1-4.3

ACAM is consistent with the upper-bound of the above test, as it effectively estimates the stand along cost of a business unit, and is therefore economically meaningful in that it provides the highest price for a service that would be consistent with outcomes under workably competitive conditions under certain circumstances. It can therefore be interpreted as providing an upper-bound for assessing whether a company's prices could be said to be excessive, in that they are inconsistent with those that would be required by an efficient new entrant that is unable to recover some of its common costs from other activities.

The Commission has expressed concern with the use of the ACAM methodology, on the grounds that it:

- allows businesses to retain all of the efficiency benefits that might be achieved through economies of scope, which is potentially inconsistent with the provisions of Part 4A;
- provides for lines businesses to subsidise the cost of providing competitive services through their monopoly components;
- allows for double-counting of costs where a company has more than one monopoly activity, such as a gas pipeline and an electricity lines business; and
- provides businesses with a substantial degree of discretion in their cost allocation.

The Commission has expressed the view that, properly applied, ACAM may provide an adequate framework for the allocation of common costs and that the above short-comings could be addressed through:

- allowing less than the full stand-alone costs to be allocated to the monopoly businesses over time;
- ensuring that the information disclosed across a number of monopoly businesses do not account for more than the total of common costs; and
- providing a greater level of prescription in the application of ACAM.

In relation to the Commission's first point, while it may be argued that allowing businesses to allocate less than the stand-alone costs to the monopoly component of their business is consistent with requiring a sharing of efficiency gains, there is not a strong economic argument for assessing how such costs should be allocated (with the exception of Ramsey pricing) and any allocation of common costs will necessarily be somewhat arbitrary. That being said, an important role of disclosed information is to allow for comparisons between businesses. Discrepancies in the way in which common costs are allocated will distract from such comparisons.

However, in doing so, the Commission should also recognise the risks associated with under-compensating businesses. We believe that an efficient company should be permitted a return above WACC, and that this is best considered in terms of the level of RROI achieved by the business as a whole. The MACAM provides a basis for comparison with a standalone, average-efficient new entrant, and should not be applied as a "best of the best of the best" new entrant test.

**10 Prescription of specific aspects:** What are your views on the methods that should be prescribed in regards:

- capital contributions

Capital contributions arise in two ways:

- explicitly, as cash sums that are paid by customers to the lines business concerned, and
- implicitly, where the lines business acquires an already existing asset (perhaps paid for and built by a subdivider) for less than its fair value or ODRC. In some cases lines businesses acquire these assets for no cash consideration.

Cash sums paid by customers appear to be correctly treated as revenue by most lines businesses, with the assets acquired presumably brought on at their full ODRC. We believe that this is the appropriate treatment under existing GAAP.

However, we are uncertain as to the extent that the different businesses recognise “implicit” capital contributions as revenue. Some businesses specifically do so, and in other cases it is not apparent how the transaction has been treated. We believe that the appropriate treatment under existing GAAP is for these contributions to be received as revenue, and the assets acquired should be stated at their full ODRC.

Failure to treat both of these types of contributions as revenues suppresses disclosed RROIs<sup>3</sup> under the existing Requirements. The difference, if not recognised as income, is not even picked up as part of a subsequent revaluation in the current RROI formula. This is because the annual ODV reconciliation report (requirement 16) requires the disclosure of assets acquired during the year at ODV – not at the “cost” recognised by the lines company in their financial statements.

There is therefore an internal inconsistency between the ODV reconciliation report (requirement 16) and the RROI calculation (requirements 14 & 15).

There is a further problem with the RROI calculation, where assets are acquired for more than their ODV. This is discussed in our response to question 17.

- inclusion of working capital

Although hardly material, working capital should in principle be part of the assets and liabilities assigned to the lines business as working capital would be required by an efficient new entrant. However, cash and short-term investments of reasonable magnitude should be included in the RROI calculation, as these are assets legitimately employed by the lines company.

As the requirements stand, if a debtor balance is unpaid on 31 March then the balance is included in working capital for RROI purposes, but if settled in cash on that day it would not be included. Clearly, keeping unnecessarily-large amounts of cash within working capital is not appropriate for an efficient new entrant.

- treatment of works under construction and finance during construction

Works under construction should, in principle, be included in the regulatory asset base, and should therefore be included as part of the denominator for the purposes of determining a RROI – because an

---

<sup>3</sup> RROI – regulatory return on investment

efficient new entrant would also bear such a cost.

Existing GAAP allows capitalisation of interest costs, and we believe this is appropriate.

However:

- the existing ODV handbook does not consider interest costs in determining replacement costs, and consequently capitalisation would result in a difference between GAAP-compliant carrying values and regulatory carrying values. The current RROI calculation would simply replace the GAAP-compliant carrying values with the ODV handbook value, and
- interest expense is largely eliminated in determining the current RROI

therefore under the existing Requirements interest capitalisation will not lead to any significant change in the reported ROI.

- expenditure capitalisation

Expenditure should be capitalised in a manner consistent with GAAP. In essence, capital expenditure is defined as all expenditure incurred in the creation of a new asset and any expenditure which results in a significant restoration, or increased service potential, for existing assets.

- customer rebates and discounts

Rebates and discounts to customers are problematic. Their treatment in the disclosures has been inconsistent amongst businesses and even within individual businesses over time. The ability of trust-owned businesses to provide a tax-deductible rebate or discount from pre-tax earnings distorts meaningful comparisons with businesses who provide a return to shareholders from post-tax earnings by way of dividends. Some businesses have consistently shown a specific rebate or discount expense, but others have not always done so. Some businesses net-off rebates/discounts from revenue, particularly in earlier years, rather than our preferred approach of stating gross revenue, with the rebate/discount incorporated as part of expenses. This will affect comparative analysis, such as revenue per customer or revenue per kWh calculations – so again it is imperative that these are stated consistently, with the gross (pre-rebate/discount) amount utilised.

Rebates/discounts given will also distort the reported RROI, with businesses providing them able to offset the rebates/discounts from income, thereby decreasing reported profitability and lowering the reported ROI measure. ROIs and other performance measures should be adjusted for this treatment to ensure like-with-like comparisons by adding back the rebate/discount, and subtracting the tax “saving” at the corporate tax rate.

- treatment of tax

As a starting point, tax expense should be calculated based on the regulatory financial statements, and should comply with GAAP. This will of course require a re-analysis of the tax calculation for the integrated business for the period. Note that disclosures of tax expense are currently made, consistent with GAAP, and the expense is audited.

Some consistency is also required as far as the treatment of tax depreciation. An efficient new entrant would have the considerable advantage of buying existing assets (at potentially significantly more than the ODV of the assets) or constructing new assets. Both of these methods will result in a considerably larger tax depreciation deduction than that available to an existing business which has held the assets for many years, or a business which was acquired through the purchase of shares. To encourage consistency with the efficient new entrant test, between line businesses and over time, we recommend that for the derivation of tax expense, ODV depreciation should replace actual network fixed asset tax depreciation.

Alternatively, the Commission may wish to consider a simplifying tax calculation, of the form:

Tax expense = (surplus before depreciation and tax less ODV depreciation) multiplied by the corporate tax rate.

Paragraph 196 of the Commission's paper suggests that the disclosure of complete statutory tax information "*so that the regulatory tax payable could be calculated and reconciled to the statutory accounts*". We believe that such disclosures add considerable additional disclosure complexity, as well as unnecessarily increased compliance costs, and as the logic behind the "split" is not provided, the disclosure will not be helpful. The role of the auditor is to confirm that the treatment is consistent with GAAP, and with the Commission's requirements.

- adjustments following mergers or acquisitions

We recognise that problems with data continuity arise following mergers and acquisitions. The most practical solution, as suggested in paragraph 234, is to prepare regulatory accounts and performance measures as if the businesses had been merged for the entire year.

In paragraph 237 the commission's paper suggests that it may require "*information for non-contiguous networks to be separately disclosed.*" Any such breakdown should be considered very carefully, especially where the business does not recognise any such differences in its own operations. Taking this argument to an extreme, one lines business operating throughout the entire North or South Island would be contiguous, but certainly there would be a number of different sets of "*interested parties that perceive themselves as a common group on the basis of their common region.*"

We recommend that the Commission does not require regional breakdowns on such a basis.

- disclosure of related party transactions

The existing disclosure of transfer payments to related parties has not been effective in identifying whether profits are being shifted from the regulated to the unregulated parts of the business. To expand disclosures would make sensitive commercial information regarding contractor pricing, margins and returns publicly available.

Broadly, three different business models have been adopted by lines businesses in undertaking construction and maintenance activities.

Firstly, a number of businesses use in-house contractors to perform either part or all of their maintenance and construction activities. In some cases, the local contracting market is relatively small, and they need to ensure the contracting skill is present. Where these businesses undertake only minimal external contracting – say up to 10% of revenues – there is minimal opportunity to shift costs to unregulated businesses.

Secondly, a number of businesses, including Orion, operate with a fully-separated subsidiary contracting business, which is allocated all of its own operating costs, and competes for all work on the basis of a lowest price conforming tender. Such an arrangement also precludes the cross-subsidisation of the unregulated business by the regulated business, as the market sets the transfer price where the related party is the successful tenderer. Disclosure of the manner of the interrelationship, and agreement by the auditor that the tender system is in place and operating, would largely avoid any further disclosure.

Thirdly, in situations where a lines business has an “internal” contracting division, which also undertakes extensive work for third parties, we recognise that there is an opportunity for the cross-subsidisation of the unregulated business by the regulated business. In such circumstances, an expanded note which outlines the business practices and provides details as to the comparable margins achieved on internal versus external work, would provide assurance that cross-subsidies are minimalised.

- treatment of pass through items

The examples mentioned in paragraph 202 (local authority rates and Electricity Commission levies) are not complex, and both could be disclosed if required.

- treatment of transfer payments

Refer to our response to related-party transactions above.

- treatment of insurance

Our total insurance costs are a minor percentage of our total cash costs. All businesses will take a slightly different approach to the extent to which they self-insure – including their tolerance of the risk associated with deductibles and various loss limits. Completely self-insuring, and therefore not incurring insurance expense, is unlikely to “push” a company towards making an excessive return. If the exclusion of insurance expense is part of the reason for excessive returns, then that should be identified as part of the subsequent Commerce Commission investigation phase.

- disclosure of investment in transmission bypass

The impact of transmission bypass clearly needs to be considered within the price threshold framework. However, we do not support the ongoing separate disclosure of the related assets, costs and revenues, because over time these become indistinguishable from the rest of the assets, costs and revenues of the business. Further, what is included in these “bypass” assets only represents a snapshot at a certain point in time, and cannot be meaningfully compared across businesses given the different level of investment each has in subtransmission assets.

- disclosure of investment in distributed generation

In our case, embedded generation is small, and specifically to support the network. Minimal cashflows arise from the sale of electricity. We believe that this is a very complex area across all lines businesses, and that further separate consultation should be undertaken.

- disclosure of investment in load management

Investment in load management equipment is a legitimate alternative to additional investment in additional network capacity, again in line with the efficient new entrant test. As such, any investment should be included in the calculation of the RROI, as should any associated expenses.

However, we view the **operation** of our load management system for other parties (eg, retailers) as a discretionary activity, “avoidable” under MACAM. There are alternatives for switching loads – for example, photocells for switching street lights. On this basis, we submit that any revenue derived from the discretionary use of our load management system, and any related costs, should not be included with regulatory income.

- any other aspects?

With some minor exceptions, easements have not allowed to be incorporated in the regulatory asset base. Easements represent a substantial investment, and are clearly part of the cost which an efficient new entrant would incur in establishing a lines business.

In our submission on the information disclosure requirements and handbook, dated 10 February 2004, we included an opinion from Ernst & Young, which clearly supported the inclusion of easements in the regulatory asset base.

**11 Disclosure—line items:** What additional line items should be required to be disclosed? What currently-disclosed line items are of little use? (Please respond by reference to the current requirements).

As outlined in our response to questions 6 and 7, we believe that lines business financial statements are not an essential component of the disclosure requirements.

What is essential is a sound underpinning principle for regulatory allocations, such as the current MACAM. However, once costs and revenues have been assigned to the lines business in accordance with the methodology, many of the subsequent specific disclosures are arbitrary, trivial and poorly-defined, and in some instances conflict with one another. This applies to such measures as:

- corporate and administration
- human resource expenses
- marketing and advertising
- consultancy and legal expenses
- consumer billing and information system expense
- employee salaries, wages and redundancies
- the breakdown of expenses to entities who are not related parties for such things as consumer disconnection and reconnection services, meter data, consumer-based load control services, and royalty and patent expenses
- the breakdown of assets into the wide minor categories including consumer billing and information systems; office equipment; motor vehicles and plant; and “other”, when these are all very small compared with the valuation of system fixed assets
- the arbitrary breakdown of asset construction from related parties into a wide variety of categories. This is particularly irrelevant where the lines company undertakes a lowest-price conforming tender process in construction
- the requirement to show a zero disclosure if no income or expenditure meets the classification.

Because of the arbitrary nature of the disclosures many costs could easily be reported under several categories. This inevitably will lead to inconsistent disclosures and extra costs – for no benefit.

For example, how should salary costs for administrative, IT or human resources staff be classified? Where should the consultancy costs associated with administrative, IT or human resources matters be classified?

We believe that these measures (and many others) are not interpreted and reported consistently from company to company, and consequently any attempt to use them for comparative purposes will not provide meaningful outcomes. We have found much of the data to be of no benefit in comparative analysis. There is also a cost to produce and analyse this data, despite no benefits being apparent. Many of the existing disclosures are trivial, and could easily be excluded.

Other important financial information is not separately disclosed – for example, replaced assets written off or customer cash or implicit capital contributions. The reported RROI and operating income are inflated for those businesses who include capital contributions in contrast to those who do not.

As a base principle, we believe that the regulatory financial statements and the financial components of the financial performance measures should be consistent with GAAP (for example, with respect to the statements of financial performance and position, calculation of income tax expense, and the various notes), and that additional disclosures above that level are only considered where there is a clear and demonstrable net benefit from doing so.

We are very concerned by the proposals outlined in the Commission's paper (paragraphs 185 and 192, amongst others) of expanded analysis regarding labour and materials disclosures. We operate a lowest price conforming tender environment for all construction and maintenance activities, and we do not have access to the labour/materials split which is faced by our contractors. Requiring this data from contractors will inevitably lead to unauditable disclosures - at significant cost, and again of no benefit to disclosure users. We believe that such required disclosures, purely for analytical purposes, also add no benefit to the operation of our business, and that all the resulting disclosures will involve, at best, rough estimates.

**12 Disclosure—further detail:** What aspects of the background to the financial statements should be required to be disclosed by way of notes? (This could include, for example, disclosure of methodologies used, and reconciliations and background calculations). Please advise what use will be made of such information.

As noted in our response to questions 1 and 11, we believe that the existing requirements are more than required. We do not believe it necessary that any further note disclosures, with the minor exceptions outlined elsewhere in this submission, are warranted.

**13 Reconciliation:** What issues are raised by the need to be able to reconcile regulatory information concerning a lines business to statutory financial information, including where this encompasses a wider corporate entity? What approaches do you suggest to address these issues?

We do not accept that there is a "need" to be able to reconcile regulatory information concerning a lines business to statutory financial information. This principle applies whether the lines business is largely "standalone", or where the lines business is one component of a wider corporate entity.

As stated in our response to question 6, we believe that the primary role of the financial statements is as an input to the calculation of a RROI, and a convenient mechanism for disclosure of specific required information.

The schedules or financial statements containing the information required to be disclosed are a standalone notional "fiction", applying a set of rules to apportion sections of an existing business in a prescribed manner.

Although for most lines businesses (namely, those which have 31 March balance dates) the starting point for regulatory disclosures is likely to be the audited 31 March financial statements, this is not possible for other businesses.

Further, we place significant reliance on the role of the auditor to ensure that allocations and apportionments made are both in compliance with GAAP and the Requirements (MACAM). We do not see any benefit whatsoever in disclosing the reconciliation back to the statutory financial statements – even when they have a common date.

As stated in our response to question 1, we support:

- clear and appropriately-principled methodologies, and
- a reduction in the extent of minor prescriptive disclosures,

and we do not accept the "need" for this additional prescription.

**14 Role of valuation:** What comments do you have on the Commission's assessment of the role of valuation in the information disclosure aspects of the Part 4A regulatory regime, in meeting the objectives of the regime?

We agree with the Commission's statements, noting particularly in paragraph 282 the requirement "*that return measures are available, that they are consistent over time and comparable between lines businesses.*" This is a key reason why we favour ODRC/ODV only. Our views are comprehensively expressed in our submission on the Commission's Asset Valuation Choice paper. Given this view, we do not see the need for or desirability of the IHC method of valuation.

**15 Valuation handbooks and guidelines:** What further aspects of the regulatory asset base valuation process need to be covered by handbooks and guidelines? In what areas do you consider that there is the greatest need for prescription?

With regard to the list in paragraph 300, we consider that prescription is needed only if their valuation is not covered by GAAP. The last sentence of paragraph 309 is pertinent – "*Where these processes can feasibly use GAAP, then the Commission will seek to utilise these.*"

We do not suggest any further aspects of the regulatory asset base valuation process that need to be covered by handbooks and guidelines. However, we recommend that easements, a fair level of cash within working capital, and works under construction should be included in the regulatory asset base, consistent with the efficient new entrant/ACAM principles.

**16 Valuation reporting:** In addition to the reporting requirements already in the ODV Handbook, what other information should be reported (for example, in relation to valuation of other assets, valuations using the HC method, updates of ODV valuations and treatments of mergers and acquisitions)?

Regarding paragraph 305, it is confusing to have valuation reporting requirements in both the ODV handbook and the Requirements. We note that the Requirements contain more than just the requirement to reconcile valuation movements (req 16). There is also a list of information to disclose (req 19(6 &7)). In both cases, we submit that these would be better consolidated within the ODV handbook.

As we have indicated in our submission on the Commission's Asset Valuation Choice paper, part 2 – response to Q7, we agree that the ODV handbook should prescribe rules for reporting the interim updates of the ODV and the treatments of mergers and acquisitions.

**17 Measurement of returns:** What return measure, or measures, best meet the objectives of the information disclosure regime?

In order for the disclosed information to encourage businesses to conform to the intent of the regime, as embodied in the threshold regime and the threat of control, it will be important for the return measures to be consistent with those the Commission uses in its assessments. For this reason, we favour the ROI measure and agree with the Commission that the ROF and ROE are not directly relevant.

We acknowledge that the RROI will almost certainly deviate from WACC in any given year. An RROI in excess of WACC would not necessarily indicate the lines business was making excessive profits, as the business may be more efficient than the industry average, or the RROI fluctuates from year to year for various reasons (such as weather or fluctuations in demand etc).

It may be possible to construct a form of RROI that attempted to correct for such effects as efficiency gains and short-term fluctuations in performance results from 'one-offs'. However, such adjustments would most likely introduce considerable discretion in the calculation of the RROI, as well as reduce the simplicity and clarity of the return measure. Therefore, we would concur with the Commission's view of retaining the simpler form of RROI, with the expectation that lines businesses would be able to explain any substantial deviations between RROI and WACC within the notes, or as part of a subsequent investigation.

In any case, the path of the RROI over time should provide relevant information regarding the sustainability and efficiency of the prices a particular lines business is charging even if it is not a reliable indicator in a single year.

We share the concerns expressed by the Commission over the shortcomings in the current prescription for calculating the RROI, and our particular concerns are discussed in the remainder of this section.

Firstly, we submit that total line revenue should be used – i.e. before any rebates or discounts (apart from prompt-payment discounts) are issued by the lines business.

We consider that the existing RROI calculation should be amended to include works under construction, a reasonable amount of cash within working capital, and the value of easements.

The existing RROI denominator should also be amended to use a correct average of opening and closing fixed assets in years where revaluations take place. The subtraction of half the amount of the revaluation from the denominator in the ROI calculation, as detailed in the current Requirements, effectively overstates the reported ROI, as the whole of any upward revaluation is included in the numerator, but the effect of the revaluation is completely removed from the denominator. Using an average reflects the reality that a revaluation is not an instantaneous event which happens at midnight on the last day of the year – instead, the revaluation applies to assets used throughout the year, which gradually increase in value.

By allowing an annual indexation of ODV the large reported ROIs which followed major triennial revaluations will be "smoothed", but a failure to allow the correct averaging of opening and closing assets employed will still overstate the reported ROI.

Annual indexation, utilising a construction-related index, is discussed in our submission on the Commission's Asset Valuation Choice paper.

Another issue also arises in the calculation of the regulatory ROI due to the divergence of regulatory asset values from the fair value required by GAAP.

Where assets are acquired below fair value (or ODRC), we recognise the “gap” as income, and this is included in the numerator of the regulatory ROI calculation. This treatment is consistent with GAAP, although a different “income” amount may arise between the FRS-3 carrying value and the regulatory value allowable – for example, if there are differences between “actual” replacement costs and handbook replacement costs. Refer to our response to question 10 regarding the tax depreciation impact of acquiring assets above ODRC.

Where assets are acquired at fair value (ODRC) which is above the ODV handbook value, a write-down (expensing) of the difference for the purpose of the RROI calculation should occur. However, this is not allowed within the GAAP-compliant financial statements (as the statements reflect “full” value), but should be allowable within the calculation of the RROI. The Commission must ensure that replacement cost values in the ODV handbook are kept up to date in order to minimise this effect.

In essence, we are currently preparing a RROI based on Handbook-derived ODRC asset values which are not necessarily GAAP-related fair values, using data derived from financial statements which are based on fair value.

We recommend that the calculation of the regulatory ROI should allow this write-down to be incorporated.

**18 Measurement of productive efficiency, dynamic efficiency and technical efficiency:**  
What information, which can be consistently and publicly disclosed, will best allow analysts to assess productive, dynamic and technical efficiency?

Consistency in the measures provided by lines businesses is of primary importance in order to be able to judge the relative productive efficiency of lines businesses. There are two broad approaches to assessing productive efficiency. The first is through the use of total factor productivity measures, of the type the Commission used in setting the thresholds. Such an approach is unlikely to be suitable for the purposes of information disclosure, since it is controversial and is neither transparent nor likely to be consistently implemented across lines businesses.

The second approach is through the use of partial productivity indicators. Such indicators must be interpreted cautiously, as the measures for individual businesses could vary widely without necessarily indicating that a particular business is ‘inefficient’. Furthermore, efficiency as measured by one parameter may come at the cost of less efficiency as measured by other parameters. That aside, partial productivity indicators can be relatively straightforward to provide and can provide useful information regarding the productive efficiency of lines businesses when considered as a whole.

Regarding the two existing measures of productive efficiency (paragraph 325), we agree that lines businesses have not always been consistent in their calculation. In line with the comments in paragraph 326, we consider that the solution is to disclose **total** costs per line-km and **total** costs per consumer / connection / ICP.

The Commission is also seeking simple performance measures of dynamic efficiency. Dynamic efficiency is the act of satisfying productive and allocative efficiencies, which are static concepts, over time. Dynamic efficiency recognises that production and consumption decisions change over time as technology advances and consumer

tastes change. Given the nature of dynamic efficiency, it seems unlikely that there will be simple performance measures of company's performance. The dynamic efficiency of decisions is only known as time progresses. While the following indicators may provide some indication of the dynamic efficiency of a business's decisions, interpretation is likely to be problematic:

- movements in the static efficiency measures over time;
- indicators of how well the current service meets consumers' quality expectations and willingness to pay (ie, customer complaints, etc); and
- examinations of capital expenditure plans in asset management plans and procedures.

For another measure of dynamic efficiency, we suggest the ratio of the optimised replacement cost to the system maximum load. This measure moves dynamically as investment and maximum loads change over time. Part 1, section 7 of our submission on the Commission's Asset Valuation Choice paper refers to the long-run average incremental cost (LRAIC) as a key part of its line pricing. We derive our LRAIC in section 3.1 of our "*Derivation of Electricity Delivery Prices*",<sup>4</sup> available on our website. LRAIC is derived from this ratio. It is a measure of the value of capital investment per kVA of peak load, the key cost driver of a lines business.

We submit that the existing measure of loss ratio should be dropped because lines businesses are unable to obtain reliable data of energy volumes output from their networks from electricity retailers.

Regarding further measures of efficiency, we suggest power factor at peak load at each GXP. This indicates how well the lines business manages the requirement for reactive power, which is a key determinant of the ability to utilize the capacity in distribution and transmission lines. This is influenced by the characteristics of the network and the GXP's ICP density should also be noted, for comparisons.

We note that the Commission has not asked about allocative efficiency in this question. Allocative efficiency is very important to ensure that the overall RROI is not too high or too low, and to ensure equity in pricing within load groups – eg, large/small customers, urban/rural customers, or customers in non-contiguous networks etc. Clearly, such cross-sectional reporting poses significant definitional problems, so further consultation would be necessary if this is required.

Finally, the Commission has asked about technical efficiency. This is mentioned for the first time in paragraph 26 of the Commission's paper, and is not defined. This also does not appear to be a term in economic literature. Accordingly, we have not responded to this question.

**19 Disclosure of statistics:** Are the existing statistics that are disclosed consistent with the implementation principles for information disclosure, in Chapter 3? Given that there is some overlap with MED requirements, is there

As suggested in paragraph 337, we would welcome consolidation of all statistical information disclosure in one place – preferably under the Part 4A requirements.

Specifically, the Requirements:

---

<sup>4</sup> Orion New Zealand Limited, *Derivation of Electricity Delivery Prices from 1 April 2003*, 27 June 2003

merit in continuing to require such statistics under Part 4A?

- a) need to clarify what “circuit lengths by nominal line voltages” means. It is unclear as to whether lighting and communication circuit lengths need to be disclosed. Consequently, there are inconsistencies in disclosures amongst lines businesses. We recommend that they be excluded
- b) need to clarify that transformer capacity is applicable only to transformers owned by the lines business. Refer also to bullet point below
- c) should change from total consumers to total ICPs. This would be the total ICPs as declared by the lines business, less any included for streetlighting.

We agree that the existing statistics that are disclosed are consistent with the implementation principles for information disclosure in Chapter 3, except that:

- transformer capacity owned by the lines businesses does not relate directly to the maximum demand (paragraph 334). Generally there is also connected distribution transformer capacity that is owned by others. As there is usually half-hour metering at the large/major consumers who own transformers, we suggest that their coincident loadings be subtracted from the network’s maximum demand before calculating this ratio, and
- maximum demand, in kilovoltamperes (kVA), is the measure of loading that the network must cope with. Orion suggests that this value also be disclosed, as well as the maximum demand in kW. Lines businesses will have to obtain this value from Transpower.

**20 Measurement of quality:** Should information on the quality of electricity distribution and transmission services encompass more than just service reliability (e.g., supply quality—including frequency, voltage and interference characteristics—and consumer services), and how practicable would it be to disclose such additional information? How can the specification of required quality measures be tightened to improve consistency? Is independent audit of quality disclosures required?

We agree with the three “dimensions” of quality given in paragraph 341 of the Commission’s paper.

We acknowledge the Commission’s concerns expressed in paragraph 351, but considers most of these problems to be unavoidable. Stakeholders are likely to be even more confused if more information is disclosed. With regard to the remedies suggested in paragraph 352, our comments are:

- a little more clarity in existing prescription could help, but not much more is needed. For example,
  - need to clarify that Total Consumers is the average of start and end of year values, and
  - need to exclude consumers that are de-energised/inactive for any other agreed reason
- disclosure at the feeder level would be far too detailed. Orion has approximately 1,000 11kV feeders. There would be far too much information to disclose. Furthermore, some are run in closed rings where reliability performance cannot be related to a particular feeder. We consider that it is useful to compare the reliability performances of networks with similar characteristics, and have consistently analysed and published urban and rural splits for our reliability performance. In line with the bullet 2 of paragraph 352, we suggest disclosure of performance with respect to each GXP. Orion has 14 GXPs.

Included for each GXP area should be the connection density (ICPs per circuit km of high voltage line length). This would enable comparisons of reliability performance by ranges of ICP density, which is a reasonable indicator of the network's characteristics and goes further than an urban / rural split. Orion's ICP densities range from 1 to 100 ICP/km. Comparative analysis could be by bands, such as 0-25, 25-50, 50-75, 75-100 and 100+ ICP/km. The previous ESEANZ scheme<sup>5</sup> had categories of:

< 9 Rural  
9 - 14 Mainly rural  
14 - 42 Mainly urban  
> 42 Urban

- we agree that analysing the causes of interruptions is useful (para 351, bullet 4), as was developed by the ESEANZ<sup>5</sup>. We have 10 categories of causes, as follows:
  - planned shutdown
  - plant failure
  - unknown
  - vegetation
  - weather & environment
  - vehicle collision
  - other 3<sup>rd</sup> party damage
  - bird
  - vermin
  - human error
  
- we agree that an independent audit of reliability performance measures may improve consistency in reporting, but believe that this will take some time across the industry.

Another useful measure of the supply quality to consumers is the number of proven voltage complaints. We record and report on this measure and have an annual target based on <4 per 10,000 ICPs.

There may be some international standards on reliability performance measurement that could be considered for NZ. An example is IEEE Standard 1366-2003, "*IEEE Guide for Electric Power Distribution Reliability Indices*" for specifying the way reliability indices are analysed. Australia is also developing standards, which could be considered by the Commission and the industry, in due course.

---

<sup>5</sup> Electricity Supply Engineers Association of NZ (ESEANZ), *Reliability Performance Measurement Scheme Manual*, October 1994.

**21 Terms and conditions, line charges and pricing methodologies:** In light of the Electricity Commission's role, to what extent might it be desirable for disclosures relating to contracts, pricing methodologies and line charges to all be disclosed under the same set of requirements? What role should the disclosure of such information serve under the current regulatory regime? How could the requirement for information in these areas be enhanced so as to ensure it satisfies the Commission's proposed objectives and principles for the regime (Chapter 3)?

We consider that the Commerce Commission should prescribe all information disclosure, including disclosures relating to contracts, pricing methodologies and line charges. We favour this arrangement because of the relative independence of the Commerce Commission and its responsibilities under Section 57T(3) of the Act. Refer also to our response to question 3.

The disclosed information provides the reference data for the threshold measures under the current regulatory regime.

We suggest the following enhancements in relation to the requirements to express line charges "*in a manner that enables individual electricity consumers to determine the total charge for line business activities for each consumer group which is applicable to them*":

- a) it is a 'price' that should be disclosed. Generally, charge = price x chargeable quantity. The terminology in the disclosure requirements are out-of-line with this convention. We suggest changing this to use of the word "price"
- b) this requirement is not appropriate, in our view, where a lines business has wholesale pricing (appropriate where an interposed agreement applies and the lines business is providing its service to retailers, not consumers). It is not possible to state a charge that applies to a consumer group. A charge can be derived, but this is subject to assumptions and is artificial because chargeable quantities are not known or even established for individual consumers within that consumer group. Therefore, we recommend that this requirement be either removed or changed so that the price can be more generally applicable to a 'connection category' or 'load group' or whatever basis that is used by the lines business.

Regarding pricing methodologies (paragraphs 377 – 379), we agree, but note that there is a very wide range of interpretation of this requirement.

**22 Auditor's reports:** How important is the role of the independent auditor in the information disclosure regime? Is the current scope of the auditor's reporting sufficient, or should it be extended to include other information disclosures? Are there any aspects of the current auditing processes that should be changed?

The independent auditor fulfills a very important role in the information disclosure regime, certifying compliance with the requirements, and aiding inter-company consistency. Many of the allocations made in accordance with the MACAM require some subjective assessments, as does the application of the ODV handbook. Accordingly, an independent audit of these disclosures is required. Other disclosures, such as system length and related measures, do not require the same level of assessment, and although independent verification may not be required – especially given the certification provided by directors as to the accuracy of the disclosed information – auditing this data would encourage consistency.

**23 Auditor's independence:** Should the requirement for auditors to be independent of the preparation of the disclosed information they audit be continued, such as in relation to the preparation of and the auditing of valuations of lines business system fixed assets?

Auditors are governed by codes such as the Institute of Chartered Accountants *Codified Auditing Standards*. We believe that it is essential that auditor independence be required, in line with the *Codified Auditing Standards*.

**24 Certification and statutory declarations:**

How important is the role of certification and statutory declarations in respect of information supplied to the Commission in relation to s 57T of the Act? Is the current scope of certificates and statutory declarations required to be prepared by directors of large line owners and large electricity distributors sufficient, or should it be extended? Are there any aspects of the current certification processes that should be changed?

We support the current level of most of the certifications and statutory declarations. However, we question the need for directors to sign Forms 7 & 8 of the current requirements. The two forms are statutory declarations, signed by a director, which are to accompany any information provided in accordance with the Requirements – so are administrative in nature. Company executives who are authorised persons should be able to make the statutory declaration on these forms, as was permitted under the Ministry of Economic Development's information disclosure regime.

**25 Publication channels and mechanisms:**

What are the most appropriate publication channels and mechanisms for the various groups of information, and what scope is there to rationalise the means of publication of information disclosure? Are there any impediments to data being gathered and published as data files (for example, being able to be uploaded to and downloaded from the Internet)?

Use of the internet has expanded considerably since information disclosures were first required in 1994.

We support the publication on company websites of all data which is required to be publicly available, together with an explanation of any changes if revised data is provided. This is our own practice, including publishing information which does not have to be so published. We do not believe that any of the disclosures now need to be gazetted.

A link to all company disclosures could be available from the Commission's website.

**26 Timing:** How realistic and reasonable are the current times allowed for information to be disclosed? Should the current financial years for Transpower and other large line owners and large electricity distributors be retained?

We have a preference for a common year-end date for the disclosure of all lines businesses. However, as a number of businesses have a 30 June balance date, the existing requirement will for some businesses be extremely onerous. Therefore we recommend that some flexibility is introduced to enable a later disclosure "cycle" for businesses with a June balance date.

**27 Publication of Commission's summary and analysis of information:** What analysis of the disclosed information would it be most useful for the Commission to undertake? What are the main questions that such analysis should aim to answer?

As discussed in our response to question 4, we currently use disclosed information to conduct a high level comparison of our reliability and network performance, level of returns, prices, and expenses, against other lines businesses.

PricewaterhouseCoopers also provide a useful industry summary.

However, we are of the view that given the variety of different lines businesses, and the conditions and circumstances of their operations, it is not possible to definitively "rank" performance, nor do not believe that extensive additional disclosures will remedy this situation.

Even the Meyrick and Associates report prepared for the Commission<sup>6</sup> identified problems with benchmarking quality of supply, and providing an adequate relationship between quality and allowable returns.

NERA's Graham Shuttleworth<sup>7</sup> explains that "*Internationally, there is no agreed understanding of the cost function of an electricity network business, given that its costs depend on both local topology and past decisions made with imperfect information. Hence, regulators cannot derive a figure for what total costs "should" be, by applying statistical techniques to cost conditions in other companies. Statistical estimates of "efficient costs" are too subjective to provide a long-term reasonable prospect of cost recovery, and would undermine incentives for efficient*

<sup>6</sup> Meyrick and Associates, Regulation of Electricity Lines Businesses, Resetting the Price Path Threshold, 3 September 2003.

<sup>7</sup> The principles of good monopoly regulation, Graham Shuttleworth, National Economic Research Associates, London, 23 February 2001, section 4.1.1.

*investment.”*

In summary, any analysis the Commission undertakes should seek to confirm that industry returns are in acceptable ranges – that lines businesses are “*limited in their ability to extract excessive profits*”<sup>8</sup>. Existing line and price quality thresholds already seek to ensure that the price, quality and efficiency objectives of Part 4A of the Commerce Act are achieved.

**28 Retention of information:** What is an appropriate policy for the retention of information in respect of the kinds of information currently disclosed? How can integrity of data be ensured following a merger or acquisition?

We recommend that the information disclosures and supporting information be retained for no more than the periods required for normal business records, as outlined in paragraph 426. In the event of a merger or acquisition, our own experience has been that it was necessary to specifically work with those individuals who had prepared the information disclosures in past years to ensure some consistency and understanding occurred. This no different to any other aspect of a business merger or acquisition.

**29 Implementation priorities and sequencing:** What are your views on the implementation priority that should be given to different aspects of the regime? Are there any matters that you consider the Commission should aim to implement before 31 March 2005? If so, then how do you propose that they should be resolved in this timeframe?

We do not support the development of the IHC methodology, as outlined in our submission on the Commission’s Asset Valuation Choice paper. If the Commission decides to continue with the option, then we agree with the priority accorded to the development of the IHC option as stated in paragraph 434. However, we consider that it would be impractical for the Commission to implement/specify the IHC option in time for a lines business to value its assets at 31 March 2005 per the IHC method. The length of time taken to revise the ODV handbook was considerable, whereas the Commission is essentially starting afresh with the IHC methodology. The Commission will have to have all details finalised by 31 August 2005 and the lines businesses would need to assess the choice soon after. We do not believe that the timetable is achievable.

Instead, it might be viable to meet the timetable for 31 March 2006, with a subsequent delay in information disclosures until late 2006. We believe that this is a significantly more practical approach than the redisclosure option discussed in paragraph 436.

However, we believe that most of the proposals contained in paragraphs 437 and 438 are logical.

**30 Implementation process and timetable:** Do you have any submission to make in regard to the process outlined for specification and implementation of revisions to the information disclosure regime?

We do not agree with the possibility raised by paragraph 439 of any changes at 31 March 2005. This could well also require the provision of comparative information, which could be very difficult to prepare. However, much of the other timetabling as discussed in paragraphs 440–444 appears sensible.

A major issue with adoption of new information disclosure requirements is the requirement within financial statements for prior year comparatives, in accordance with GAAP. When the information disclosure handbook was released by the Ministry of Economic Development in 1999 the compliance with GAAP forced businesses to provide prior year information, even though the handbook specifically provided an exemption.

The Commission should also be aware that many businesses are currently working to implement new international financial reporting standards (IFRS). In our case, this is likely to be from 1 April 2006, although other businesses may be on the verge of adoption now, and

---

<sup>8</sup> Commerce Act, part 4A, s57E

others may postpone for a further twelve months. This process will also delay the ability for businesses to provide meaningful and consistent disclosures, as during the implementation phase GAAP will be governed by two different sets of standards.

These issues would be greatly reduced in impact if the approach outlined in our response to questions 6 & 7 (namely, the requirement to provide financial statements) was removed or delayed.

**31 Workshops:** Do you consider that the use of workshops would be useful to help clarify implementation details on certain aspects of the information disclosure regime? What aspects of the process would most benefit from workshops? How could workshops be organised to operate most effectively and efficiently?

We would find workshops useful, especially in outlining information disclosure specifications and methodologies; measures of efficiency; and in the indexing of the ODV handbook.