



**SUBMISSION TO COMMERCE COMMISSION**

**Regulation of Electricity Lines Businesses  
Review of the Information Disclosure Regime Discussion  
Paper and Implementing Valuation Choice for System  
Fixed Assets, Draft Decisions and Discussion Paper**

**18 March 2005**

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# 1. Introduction

1.1 Marlborough Lines provided a submission to the Commission on the two discussion papers;

- Regulation of Electricity Lines Business Review of Information Disclosure Regime.
- Regulation of Electricity Lines Businesses Implementing Valuation Choice for System Fixed Assets.

1.2 We thank the Commission for the opportunity to expand on some aspects of our previous submission and raise some other issues identified since that submission was prepared.

1.2 Marlborough Lines is party to and fully supports:

- The submission prepared by PricewaterhouseCoopers (PWC) on behalf of 21 large ELBs.
- The submission prepared by the Electricity Networks Association.

## **2. Purpose of Regulation**

- 2.1 We appreciate and recognise the Commerce Commission has had responsibility imposed upon it relative to monitoring the performance of ELBs.
- 2.2 Irrespective we respectfully request that the Commission undertake a cost benefit analysis in each area where further changes to the existing regulatory regime are proposed.
- 2.3 Over the last three years Marlborough Lines regulatory compliance costs specific to the electricity industry excluding safety etc have been in the vicinity of \$300-\$350,000 or approximately \$16 per consumer. In our case this \$16 per consumer represents approximately 4% of the net amount received by the company for line charges for a typical domestic consumer as defined by the Ministry of Economic Development.
- 2.4 We also respectfully submit that increasingly the thrust of the Commerce Commission seems to be moving towards looking at inputs and process rather than focus on quantifiable outputs.
- 2.5 A comparative analysis of specified criteria for a wide diversity of ELBs at a snapshot in time can only be meaningful if varying parameters are taken into account and when this is undertaken the validity of the comparison typically collapses.
- 2.6 Marlborough Lines is a part owner of New Zealand's most dense network with Nelson Electricity (36.5 consumers per kilometre) and the least dense network OtagoNet with 3.3 consumers per kilometre. Our intimate knowledge of our own and these other two networks illustrates to us that the value of comparisons is limited given the huge disparity between almost all aspects of the networks.
- 2.7 In any event from a consumers perspective the items of interest relative to electricity supply are:
- Reliability
  - Quality
  - Price

In each of these areas the consumer's measurement criteria is in real time. In the first instance individual concerns are addressed through direct representation by

consumers to the ELB or even through local public pressure if the circumstances were to be serious.

- 2.8 Consumers also have the opportunity to make a complaint to the Electricity Commissioner who has the capacity to address any injustices suffered by the consumer.
- 2.9 It is respectfully suggested the importance of this aspect of consumer protection should not be overlooked.
- 2.10 An ELB is a long term business with long term assets and requires long term planning.
- 2.11 Through increasingly intrusive and prescriptive regulation particularly in relation to the valuation of assets and classification of expenditure it is inevitable network companies will be disinclined to invest in research and development or pursue new opportunities to the longer term detriment of the industry.
- 2.12 In general the regulatory requirements should not inhibit sensible longer term investments nor the appropriate maintenance of assets.
- 2.13 In New Zealand unfortunately there are a number of examples where insufficient investment in infrastructure assets has been to the ultimate detriment of the community, country and economy.
- 2.14 Further, from an environmental perspective, regulation has been detrimental to Marlborough. For a period of over twenty years the company and its predecessor embarked on a program of overhead to underground conversion in conjunction with the Marlborough District Council. This program had the support of the wider community but has been curtailed simply because the true cost of the company's investment could not be reflected in its ODV valuation.
- 2.14 In the case of Marlborough Lines the company is Trust owned and all the benefits of operations are either reinvested in the network or returned to Marlborough consumers. In this regard it seems incongruous that tight controls are imposed on Marlborough Lines as a network company when energy suppliers continue to be unregulated. By way of example over the period 15 November 1999 to 15 November 2004 TrustPower and Meridian charges increased by 64.43% and 82.2% respectively whilst Marlborough Lines network charges reduced by 9.24%. These percentages are

based on Ministry of Economic Development data for an average domestic consumer using 8,000 kilowatt hours per annum.

### **3. Information Disclosure Regime**

#### **3.1 Objectives, Principles and Information Needs**

- 3.1.1 Paragraph 12 in the Executive Summary summarises a number of statements made in Section 3 of the discussion paper. The discussion paper appears to be of the view that *“information disclosure is for the benefit of a wide range of interested parties, each with their own needs. The Commission wishes to ensure that the revised regime meets those needs and does not require information that is of limited value.”*
- 3.1.2 In our experience, there is very little public interest in the information disclosed. Most consumers are not even aware that such information is available to them.
- 3.1.3 Later in paragraph 12, a further statement *“Some information may also be required to provide transparent reconciliations with other data, including data in statutory financial statements. This may include the need to disclose some information about the overall business of the line owner, as distinct from information solely relating to electricity transmission and distribution services.”*
- 3.1.4 As outlined earlier Marlborough Lines is part owner of two other electricity networks, Nelson Electricity and OtagoNet. Additionally, Marlborough Lines operates a relatively substantial contracting business.
- 3.1.5 Given that Nelson Electricity and OtagoNet will, we understand from the Discussion Paper, be required to disclose information in the same manner as any other large ELB, it would seem unnecessary to require Marlborough Lines to include information relating to its investments in those two ELBs in its own information disclosure.
- 3.1.6 Similarly, disclosure of information relating to the contracting business can be of benefit to no other party than the company’s competitors who have no such obligations.
- 3.1.7 As stated in our submission, we are concerned that the general tone of the Commission’s discussion papers appears to discount the value of the role of the auditor of the disclosed information. We submit it would be more efficient for the Commission to provide a greater level of guidance and prescription to disclosing entities and their auditors rather than to require additional disclosure of information of a general nature, including information relating to any “other” businesses.

- 3.1.8 In paragraph 18 of the Executive Summary the Commission notes that it *“tends to favour tightening their prescription of certain data items and notes that it should be an objective for the database of disclosed information to be able to be analysed without the need to make a range of adjustments to correct for differences between businesses, or over time, in methodology or interpretation.”*
- 3.1.9 Information disclosed cannot be meaningfully analysed on a comparative basis to make sense without accepting that there are fundamental differences between networks. Some are substantially underground, some are constrained within small geographic areas, some have one or two significant industrial customers who make a significant impact on consumption and efficiency statistics. Some, like Marlborough Lines, have extensive subtransmission networks from a single point of connection to the Transpower grid.
- 3.1.10 Other company’s networks are substantially overhead, cover large rural and remote areas, have no large industrial customers, or have multiple points of connection to Transpower’s grid.
- 3.1.11 Further levels of prescription and information disclosure based on the incorrect assumption that all ELBs are comparable would be inconsistent with the Commission’s stated principle of minimising compliance costs. And we do not believe it is cost efficient, sensible, or indeed possible, to disclose information to the extent which would be necessary to allow all these differences to be accounted for in an exercise of comparability.

## **3.2 Financial Statements**

- 3.2.1 Whilst it is accepted that the regulatory accounts may have a different purpose to the statutory and financial statements, we strongly believe that the regulatory accounts should continue to be constructed in accordance with GAAP in order to minimise both the accounting and auditing compliance costs. The Financial Reporting Standards are subject to an evolutionary process including the current move to embrace International Financial Reporting Standards. The current situation where network business financial statements are derived from GAAP Compliant Statutory Financial Statements ensures consistency from an accounting perspective and it also ensures that such accounts can be readily audited by suitably qualified and experienced members of the accounting profession.

- 3.2.2 We acknowledge that in the past some aspects of the disclosure regulations have required practices which are not GAAP compliant. Marlborough Lines received a qualified audit report for its disclosure accounts due to the regulatory requirements differing from the Financial Reporting Standards in the area of consolidation.
- 3.2.3 We also note from paragraph 21 of the Executive Summary, the possibility that *“methods of valuing non-system fixed assets would be prescribed in a further handbook or handbooks.”* The current method for valuing these non-system fixed assets adopted by Marlborough Lines and we believe most other ELBs is to value these assets at current valuation for land and buildings and depreciated historic cost for all other non-system fixed assets. Any move away from this type of valuation would result in non-compliance with GAAP requirements. We are concerned to note in paragraph 156 that the Commission appears to be intending to prescribe asset lives and depreciation schedules to *“... better ensure comparability between businesses”*. We presume here the Commission is referring to non-system fixed assets.
- 3.2.4 As mentioned earlier, we are concerned that endeavours by the Commission to achieve *“better comparability between businesses”* would be in conflict with the Commission’s principle of minimising compliance costs, and in any event any changes arising from such over prescription would be expected to be immaterial.
- 3.2.5 The Commission suggests, in paragraphs 163-165, introduction of the requirement to provide projected financial information additional to that currently provided in Asset Management Plans.
- 3.2.6 Marlborough Lines fully supports the PWC submission in this regard, that such financial projections are not required to meet the purpose of subpart 3A of the Act, nor the implementation principles outlined in table three on page 36 of the disclosure paper.
- 3.2.7 We acknowledge such information may properly be required by the Commission in its investigation of a threshold breach. It should not however be required to be publicly disclosed given the potential for variances arising from changes in consumer requirements.
- 3.2.8 The Commission also suggests, in paragraph 170, that *“the assets included in the Statement of Financial Position may correspond to the regulatory asset base the Commission would use in an assessment.”*

- 3.2.9 We strongly disagree with this statement. This is not the case at present, and we do not believe it should be in the future. Differences in network values and depreciation should continue to be adjusted in a derivation table.
- 3.2.10 To do otherwise introduces a further level of non-compliance with GAAP and further costs of compliance, both of which we submit are totally unnecessary.
- 3.2.11 Paragraphs 173-176 discusses the Commission's views with respect to works under construction and finance during construction. Once again, the current process of allowing average annual works under construction to be included in the Regulatory Asset Base is the least cost approach from a compliance perspective, and is readily auditable.
- 3.2.12 A study of the 2004 Information Disclosure shows that in total for all ELBs (excluding Transpower) average work under construction totalled \$4.3m, 2.1% of total ODV values. We submit that any further complexity in establishing finance during construction costs for such a small portion of the Regulatory Asset Base cannot be justified. We would however accept that Transpower, and occasionally some other ELBs may have material levels of work under construction. We therefore suggest the Commission consider making the option of including Financing costs and excluding works under construction from the asset base where the level of work is material (as defined by the Commission).
- 3.2.13 Paragraphs 189-193 deal with operating expenditure. Marlborough Lines is particularly concerned with the statements in paragraph 192 that the Commission's consultants, Meyrick *"recommended that disclosure should better identify labour cost to assist with bench-marking business performance. In particular, Meyrick suggested that labour usage and cost (including the labour component of contracted services), quantity and cost of own labour used on capital construction projects, and purchase of materials and services (operating costs excluding labour) be disclosed. This would require more detailed disclosure than is currently the case."*
- 3.2.14 Where external contractors provide services, it would not be possible to extract the labour component. And, as mentioned earlier, all ELBs are not the same. Construction costs of works in an urban area will invariably differ from costs of works in a remote rugged area accessible only by boat or helicopter. Any attempt to "bench-mark" line business performance where such significant differences exist

would be fraught with significant difficulties, and would in all probability result in erroneous outcomes.

- 3.2.15 Once again, the costs of compliance with the suggestions contained in the discussion paper would appear to us to significantly outweigh any perceived benefit accruing from any additional disclosure.
- 3.2.16 We are concerned with an apparent inconsistency in paragraphs 212-215 of the discussion paper, dealing with Statement of Cashflows.
- 3.2.17 The paper appears to totally ignore the concept of accrual accounting. We submit that a cashflow statement is not the appropriate place to find such information.
- 3.2.18 For example, Asset Management Plans capital expenditure will invariably be based on accrual accounting. To attempt to compare such accrual accounting projections with cash accounting actuals is nonsensical. Any such comparison should be on an accrual basis and if considered necessary by the Commission be included in a separate section.
- 3.2.19 Application of the Avoided Cost Allocation Methodology (ACAM) is discussed in paragraphs 219-229. Marlborough Lines supports retaining the current ACAM approach, but suggest the Commission should provide further guidance on its application.
- 3.2.20 We are however concerned with the suggestions within the paper that further disclosure of information in this regard may be required. Once again we see this as seriously discounting the value of the role of the auditor of the disclosed information.
- 3.2.21 Obviously following a threshold breach the Commission may seek further information from individual ELBs. However, it is we submit unnecessary to force all ELBs to meet the additional compliance costs involved in such exercises.
- 3.2.22 We are significantly concerned with the suggestion in paragraph 235 and elsewhere in the discussion paper that non-contiguous networks with common ownership should be required to disclose information on a separated basis. The heart of the issue is the efficiency and profitability of companies or entities which provide network services. Reduction in overall cost of compliance with the Commission's regime is one area where synergy gains can be made from mergers and acquisitions through the lowering of average compliance costs per customer.

- 3.2.23 A requirement to separately disclose information on all non-contiguous parts of a network would introduce a further range of cost allocation issues, requiring further prescription which would in all probability introduce further anomalies.
- 3.2.24 We agree that in the year of acquisition, ELBs should be required to make some special disclosures. It is however important for the Commission to recognise that they should not place on the acquiring party a need to disclose information in respect of the acquired entity pre the acquisition of that entity.
- 3.2.25 It is also important to ensure that any “time-series” disclosure is meaningful. This is particularly relevant in the efficiency performance measures such as load factor and reliability data.
- 3.2.26 We applaud the Commission’s preference for a “simple treatment” of the issue of information disclosure on investment in distributed generation. In particular, it is essential that a commonsense materiality limit be provided, since distributed generation is currently in its infancy, and has minimal if any effects on an ELBs operations.
- 3.2.27 The question of materiality also arises in respect to investment in load management. It is our understanding that most ELBs have retained the central signal generating equipment while some retain the consumer based control receivers and others sold these receivers to energy retailers. These variations diminish any perceived benefits of comparability.
- 3.2.28 Investment in the central signal generating equipment will generally be of a step nature as old equipment is replaced or new equipment commissioned. However, the operating cost of such equipment will generally be immaterial in terms of an ELBs overall operating cost.

### **3.3 Performance Measures and Statistics**

- 3.3.1 The Commission rightly identifies a problem with the present definition of direct and indirect costs being open to differing interpretations. Further prescription in this regard would be appropriate.
- 3.3.2 There is however a danger in attempting to over simplify the disclosure information in this regard. The different denominators (line length and consumers) were originally introduced in recognition of differing consumer density across different

ELBs. The number of ICPs does not necessarily impact on direct system operating costs.

3.3.3 If a single, common denominator is being sought, Marlborough Lines would prefer use of system length.

3.3.4 Our earlier submission expressed our concern with use of distribution transformer capacity utilisation in comparing networks. It is salient that the laws of physics frequently dictate that multiple consumers cannot be supplied from a single transformer because of voltage limitations. We reiterate that a number of factors, both geographic and consumer mix, can also impact on this statistic.

3.3.5 Our earlier submission also advocated that any changes in the area of quality be signalled well in advance of introduction. Significant changes in this area may result in the need to invest in further monitoring equipment to ensure information is available to comply with whatever the Commission ultimately requires. But again the cost benefit of further disclosure requirements must be considered.

3.3.6 Currently ELBs and consumers are monitoring electricity supply on a real time basis and it is respectfully suggested disclosure of further historical information will not be of benefit to consumers.

3.3.7 It would be preferable for the information disclosure required by the Commission to be sufficient to meet the requirements of other Government agencies such as the Ministry of Economic Development or the Electricity Commission. We therefore urge the Commerce Commission to liaise with these other agencies to facilitate such an arrangement.

3.3.8 These same comments equally apply to other disclosures such as terms and conditions, line charges and pricing methodologies.

## **4. Implementing Valuation Choice**

- 4.1 The valuation methodology, price path and returns assessment have been identified by the Commerce Commission as being closely related. Is it clear that the current price and quality thresholds alone are not sufficient to meet the purpose statement of subpart 1 of part 4A of the Commerce Commission Act.
- 4.2 ELBs with higher prices and consequentially higher returns at the start of the Commission's regime are advantaged relative to those ELBs with low prices and low returns at the start of the regime. This later group will be forced into a situation of breaching the price path thresholds if the viability is to be maintained in the longer term. Marlborough Lines is one of this later group whose low prices at the start of the regime have resulted in breaches of the price path threshold and subsequent investigations by the Commission.
- 4.3 Part of the outcome of that Commission's investigation has led to a focus by the company on the issue of revaluation (or indexing under DHC) component of the measurement of that commercial return.
- 4.4 The Commission has formed the view that revaluations should be included in the revenue section of an ROE calculation.
- 4.5 Whilst Marlborough Lines accepts that over the life of the assets, such an approach may be appropriate, we are concerned that ELBs are forced into the situation of earning lower revenues in the short term with the prospect of higher revenues being available in the future. However, the future, is uncertain because of:
- Political risk – the regulatory regime may be altered;
  - The potential for further regulatory intervention in the future;
  - The risk of a mismatch between asset cost inflation and current inflation.
- 4.6 We submit that, if revaluations are required to be included in the ROE calculation, that some form of "probability weighting" should be applied to the revaluation adjustment.
- 4.7 Furthermore, there is in the short term the possibility of significant impact on an ELBs financial position. Regulation which limits line business cashflows below otherwise justifiable levels must impact on capital expenditure programs. And this at

a time when ELBs have signalled the need for greater investment in network capacity to meet the significant increases in demand experienced over the past few years.

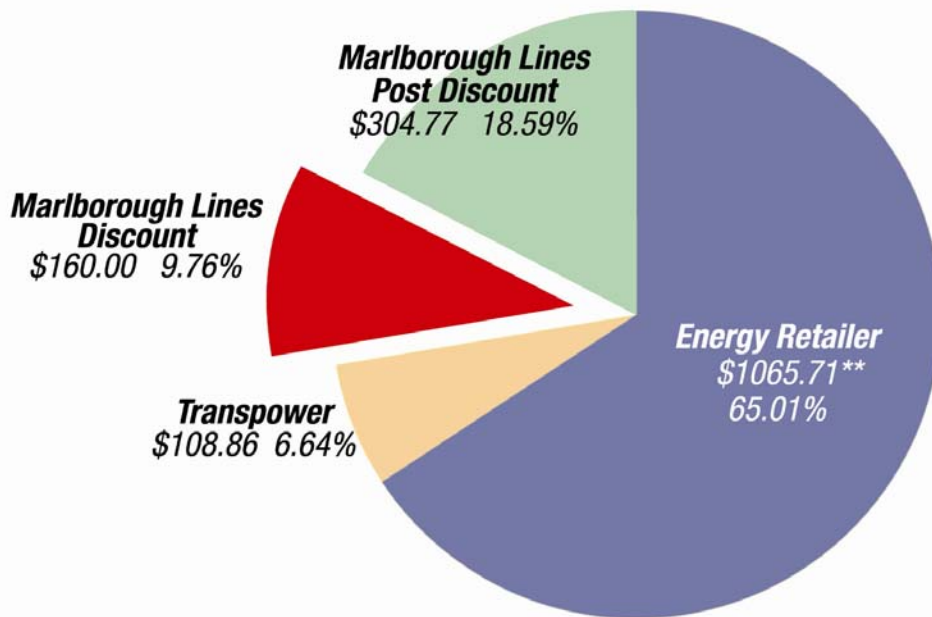
- 4.8 We are concerned the proposed approach does not recognise the mismatch between the “recognition” of a valuation gain and the achievement of that gain.
- 4.9 As outlined in our submission, we also are significantly concerned by the suggestion in the discussion paper that ELBs will be expected to make a “once and for all time” decision regarding the choice of valuation methodologies. We note from the timetable accompanying the information disclosure discussion paper that the Commission currently plans to release the final disclosure requirements and historic cost handbook at the end of October 2005.
- 4.10 If the Commission’s “once and for all time” requirement on choice of valuation methodologies were to prevail, this choice would be the most important decision faced by an ELB since the Bradford reforms in 1999. To allow companies a maximum of six months to make such a decision is in our view totally unreasonable. Given the Commission’s past performance in meeting such deadlines, it is probable the time available would be even less.

## **5. Conclusion**

- 5.1 We thank the Commission for the opportunity to present this submission on the two discussion papers. We would be happy to answer any questions the Commission members may have.

Ken Forrest

**Managing Director**



**Allocation of the Average Power Account  
for Typical Domestic Consumer\***

\* As defined by the Ministry of Economic Development

\*\* Based on TrustPower standard price for domestic consumers at July 2004