

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

1. Introduction

1.1 The Commerce Commission (“the Commission”) is required under Part 4A of the Commerce Act (“the Act”) to set thresholds for the declaration of control in respect of electricity distribution and transmission services supplied by large Electricity Line Businesses (“ELBs”). In addition, the Commission is required to implement an information disclosure regime. The Commission has gazetted the initial thresholds and initial Disclosure Requirements. It has also released discussion papers supporting the ongoing development of the new regime including the following papers:

- Regulation of Electricity Lines Businesses, Review of the Information Disclosure Regime Discussion Paper, 24 December 2004, (“the Disclosure Paper”), and
- Implementing Valuation Choice for System Fixed Assets, Draft Decisions and Discussion Paper, 24 December 2004 (“the Valuation Paper”).

1.2 The Commission has sought submissions on these two papers from interested parties.

1.3 Marlborough Lines is party to and fully supports a submission prepared by PricewaterhouseCoopers (PWC) on behalf of 21 large ELBs.

Structure of this Submission

This submission is structured in three principle sections, (in addition to the Introduction), as follows:

2. Marlborough Lines, a brief description of the company and its network.
3. Review of the Information Disclosure Regime, - our response to some of the questions raised in the Disclosure paper.
4. Implementing Valuation Choice, including some general comments and our response to some of the questions raised in the Valuation Paper.
5. Conclusion.

2. Marlborough Lines

- 2.1 Marlborough Lines Ltd (“Marlborough Lines” or “the company”) is owned for and on behalf of the consumers of Marlborough and itself owns and operates the electricity sub-transmission and distribution network in Marlborough. It also has investments in the Nelson and Otago distribution networks.
- 2.2 In Marlborough the company delivers electricity to approximately 22,000 consumers, the majority of whom reside in Blenheim or Picton with the remainder dispersed throughout Marlborough. Unlike many other networks the company has a single point of supply from Transpower in Blenheim with an extensive 33kV sub-transmission system. The network extends to a number of very isolated areas, including the Marlborough Sounds and the East Coast valleys (along the region’s southern sea coast), which pose unique challenges for electricity supply.
- 2.3 The Marlborough network has in excess of 3,000km of line of which 80% is required to supply only 20% of the consumers, resulting in the very low consumer density of approximately 1.03 consumers per kilometre for a large portion of the network. Overall Marlborough Lines’ consumer density is 6.53 consumers per kilometre of line, tenth lowest of the 28 lines companies in the country, and significantly lower than the 11.1 consumers per kilometre average density.
- 2.4 Aside from the exceptionally low consumer density for some 80% of its network the difficulty for the company is that the low density lines are very remote, traverse difficult terrain and are subject to a harsh environment. Notwithstanding these very real difficulties the company has consistently maintained high levels of reliability overall.
- 2.5 The company’s investments include a 50% share of Nelson Electricity Ltd, the electricity network that supplies approximately 8,500 consumers in the city of Nelson, and a 51% share in OtagoNet, the joint venture that owns the Otago electricity network which supplies approximately 15,000 consumers in the greater Otago region. These investments were funded by proceeds from the sale of the company’s generation assets and energy business, following the Bradford reforms in 1998, and by loan.

2.6 Marlborough Lines is owned by the Marlborough Electric Power Trust. The trustees, elected by the consumers, hold all of the shares in the company for and on behalf of the consumers served by the company. All profits are either reinvested in the network for the benefit of those consumers or paid to consumers by way of an annual discount. No parties other than electricity consumers can benefit from the company's returns.

3. Review of the Information Disclosure Regime

- 3.1 This section provides our responses to some of the Disclosure Papers specific questions on the review of the Information Disclosure Regime itself.

Chapter 2: Statutory Framework for Information Disclosure

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?*

2.1 Marlborough Lines has on numerous previous occasions raised with the Commission its concern that the cost of compliance with the Commission's target control regime have, to date, far outweighed any benefits which the consumer owner's of the company have obtained.

2.2 We are therefore significantly concerned at the suggestion in the discussion paper that information disclosure requirements could be extended to aspects of the business other than those associated with the provision of line function services to consumers.

2.3 As outlined in the previous section, Marlborough Lines is part owner of two other electricity networks. It is our interpretation of the discussion paper that both these networks, Nelson Electricity and OtagoNet, will continue to be required to comply with the information disclosure regime. It therefore seems incongruous to us that we may be required to include, in Marlborough Lines information disclosure, information relating to our investments in the ownership of those two networks, which investments are, under the current Requirements, categorised as "other" business.

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?*

3.1 As outlined in the PWC submission, we submit it is important that the two Commissions work closely together to ensure there is no overlap between their respective disclosure requirements. Further the two Commissions should

align their disclosure timetables and mechanisms to ensure compliance costs are minimised.

- 3.2 We are concerned that, if the two Commissions do not closely liaise with each other, ELBs will be placed in a position of incurring further costs to compile marginally different sets of disclosure information.
- 3.3 The lines industry has been inundated with papers, rule changes etc from the Electricity Commission over the past year. Marlborough Lines, and we believe many other small and medium sized ELBs, do not have the resources to enter into the submission process on most of these. We can only select areas where we suspect there may be significant commercial implications.
- 3.4 It may be that there are a number of areas where the Electricity Commission's requirements may differ from those suggested in the Commerce Commission's discussion papers.
- 3.5 We submit it is important for staff from the two Commissions to closely liaise prior to the Commerce Commission making any final decisions in respect to its information disclosure regime.

Chapter 3: Objectives, Principles and Information Needs

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?*
- 4.1 As outlined in the PWC submission, the Commission's own consultants, Meyrick and Associates, commented on the inadequacy of the historic disclosed information in a number of areas. We see little in the discussion paper which addresses many of these perceived inadequacies.
- 4.2 The presence or not of a single large consumer appears to have had a significant impact on the level of X factor applied to individual ELBs. And

no information was available on the topography, characteristics, density etc of different parts of an ELBs network.

- 4.3 If it is the Commission's intention to use the disclosed information for the purposes of resetting the X factors at the end of the current threshold regime period, then we believe it is essential these matters be addressed so that more meaningful information may be available to the Commission and/or its consultants at the time of that reset. This however is not a suggestion that the information regime be expanded to cover such matters – rather a comment that, if the Commission intends to adopt a similar approach to the setting of X factors in the future, they should engage their consultants earlier in the process to enable those consultants to become more aware of the significant differences between the areas supplied by various ELBs.
- 4.4 We are concerned at the escalating costs incurred in providing additional disaggregated information which has no direct relevance to the price and quality deliverables of a lines business. Most consumers are only interested in price and quality. A few larger consumers may be interested in aspects of an Asset Management Plan, however the vast majority of consumers have no interest at all in any of the information disclosed – in fact many would not even be aware that the information was available to them.

Chapter 4: Financial Statements

5. ***Role of Disclosed Financial Information:*** *What do you perceive to be the primary role of disclosed financial information in the future? What information is of most value in fulfilling this role?*
- 5.1 We are concerned to note in Section 171 the statement “*lines businesses are currently required to value system fixed assets in the regulatory accounts using the ODV method.*” This statement is incorrect, since currently ELBs may value their system fixed assets for FRS-3 purposes, and include that valuation in the regulatory accounts. The adjustment to ODV value is then made in the derivation table. We acknowledge that some companies use ODV value for FRS-3 purposes, however that is not universal.

- 5.2 We support continuation of the current methodology, since for those companies who use an FRS-3 valuation which is different to ODV, inclusion of the “book value” in the regulatory accounts enables these accounts to be GAAP compliant.
- 5.3 We fully support the PWC submission in the remainder of this area, and see little benefit reiterating any of the points made in that submission.
- 5.4 As a general comment however, the general tone of the Commission’s Discussion paper appears to seriously discount the value of the role of the auditor of the disclosed information. As outlined under question nine in the PWC submission, 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 than to require additional disclosure of information of a general nature.

Chapter 6: Performance Measures and Statistics

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

Dynamic Efficiency

- 6.1 The PWC submission suggests that “... *expenditure on extensions and network enhancement can be assessed against load growth.*” It is important to recognise that electricity network assets are long life assets which cannot efficiently be added to in incremental steps. It is not commercially efficient to marginally increase the size of a conductor on a high voltage line to provide capacity for a new load. Given the 70 plus year life of aluminium conductors, where a capacity upgrade is required it is considered sensible to install a conductor which could be expected to meet the load requirements in that area for a minimum of 15 years and more probably up to 30 years.
- 6.2 It is also relevant that the new load may be of a type that does not contribute to the network system maximum demand. This is certainly the case in a number of significant capacity upgrades Marlborough Lines has and is currently carrying out to increase capacity for a number of large irrigation schemes. Irrigation is by its very nature a summer only load, whilst Marlborough Lines historic and expected future maximum demand occurs during the winter. Hence a capacity upgrade may be required to meet consumer demands, but not result in any increase to System maximum demand.

Technical Efficiency

- 7.1 Marlborough Lines has on previous occasions commented on the use of distribution transformer capacity utilisation as a technical efficiency measure.
- 7.2 It should be patently obvious that a dense urban network such as Nelson Electricity should have a much higher capacity utilisation factor than companies such as Marlborough Lines with significant rural areas and irrigation loads.

- 7.3 Simply, in rural areas the distance between consumers typically precludes shared transformers because of voltage drop limitations. Rural consumers require a transformer sized for their own maximum demand, while urban consumers can share a transformer with the resultant diversity allowing a lower installed transformer capacity per consumer.
- 7.4 Irrigation is almost entirely summer load whilst Marlborough Lines maximum demand occurs mid-winter. We have approximately 15MVA of transformer capacity currently connected to supply irrigation only loads.
- 7.5 Additionally in Marlborough a significant primary production sector tends to have summer or autumn loads with little contribution to winter maximum demands.
- 7.6 We have also previously commented on how the presence of one large consumer can significantly impact on transformer capacity utilisation.
- 7.7 For the reasons set out above, we urge caution in using transformer capacity utilisation as a measure of Technical Efficiency.
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?*
- 8.1 We concur with the PWC submission in this regard.
- 8.2 And we would add an appeal to the Commission to ensure that, if further measurements of quality are ultimately to be required, ELBs be given sufficient time to ensure any necessary recording equipment and/or systems are in place to gather the information.
- 8.3 We are concerned with the statements in Section 438 that service quality matters “... may not be finalised until late 2005 ...”. Depending on the type of service quality information required, and given the fact that many such long

term deadlines have the habit of being extended, it is possible that ELBs would face significant difficulty in installing any necessary new measuring equipment in time to allow the information to be gathered for the full 2006/07 disclosure year.

Chapter 9: Publication and Retention of Information

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?*

9.1 The PWC submission suggests that pricing methodologies should be published at the same time new tariffs are introduced, if the methodology has changed. We would add to that a comment that, if the methodology has not changed, then a simple statement to that effect should suffice.

General Comment

We have above commented on some specific questions raised in the Discussion paper. The absence of comment on other aspects or questions raised in the paper should not be taken to indicate we have no concerns regarding these items. The PWC submission generally sets out our views in regard to other matters in the Discussion paper.

4. **Implementing Valuation Choice**

- 10.1 There appears a common thread throughout the Valuation paper indicating the Commission assumes lines businesses will undertake inefficient investments. As we have mentioned earlier, electricity line assets are long-life assets. This is particularly true of the major components of an electricity network, lines, cables and transformers, which could all be expected to have a life of between 50 and 100 years. The fact that the 2004 ODV exercise resulted in minimum optimisation of assets constructed over the past 70-80 years indicates that, even in the earlier years when no thought of thresholds, information disclosures regimes or mandatory asset valuations existed, ELB engineers constructed assets which were of appropriate size for the life of those assets.
- 10.2 To now suggest, given the current climate, that ELBs are likely to “gold-plate” their networks is in our view totally erroneous.

6. ***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?*

- 11.1 We strongly support the submission in the final paragraph of the PWC submission on this question, regarding the opportunity for an ELB to change their choice of valuation methodology at the time of major reviews of the handbook/s.
- 11.2 We are concerned in this regard that any companies adopting the HC method may find they become advantaged or disadvantaged as a result of the Commission’s future decisions regarding indexing of HC. It is unpalatable to us to be expected to make a “once and for all time” decision in this regard.
- 11.3 The absence of comment on other aspects or questions raised in the paper should not be taken to indicate we have no concerns regarding these items. The PWC submission generally sets out our views in regard to other matters in the Discussion paper.

5. Conclusion

12.1 We thank you for the opportunity to comment on the two Discussion papers, and advise we wish to attend the Commission's conference in March 2005 to further expand on various aspects of the Discussion papers.

A handwritten signature in black ink that reads "Ken Forrest". The signature is written in a cursive style with a large initial "K".

Ken Forrest

Managing Director