

COMMERCE COMMISSION HEARING

RE: ELECTRICITY LINES REGULATION: REVIEW OF THE
INFORMATION DISCLOSURE REGIME AND IMPLEMENTING VALUATION
CHOICE FOR SYSTEM FIXED ASSETS
18 MARCH 2005
Commenced at 10.30 a.m.

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Steven Boulton, CEO
Tom Weston QC and/or Victoria Heine, Partner, Chen &
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Jeff Balchin, Director, The Allen Consulting Group
Matt Pritchard/Joanna Perry, Partners, KPMG

Pricewaterhouse Coopers

Lynne Taylor, Director, Corporate Finance

The Lines Company

John Anderson, CEO
Brent Norriss, Engineering Manager

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Howard Cattermole, Regulatory Strategy Manager
Peter Franklin, Financial Controller
Glen Thomson, Grid Economic Manager

Unison Networks

Ken Sutherland, CEO

Allan Carvell, GM Financial & Corporate Affairs

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John van Brink, GM Sales & Marketing

Peter Alsop, Regulatory Manager

Duncan Head, Transmission Valuation & Development Manager

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Anton Murashev, Regulatory Analyst

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WEL Networks

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PRESENTATION ON BEHALF OF PRICEWATERHOUSECOOPERS

CHAIR: I think I will go ahead and convene the hearing because there's a bit of housekeeping matters we need to take care of.

So, I'd like to welcome you to the second day of the Commission's conference on the review of the information disclosure regime and also its implementing valuation choice for system fixed assets.

Before we start with today's agenda, I would just ask Commission staff now to advise interested parties on the programme for today. Calum is out of the room but Alec, can you do that please?

MR MLADENOVIC: The programme for today is from 10.30 until 12.30 p.m., PricewaterhouseCoopers.

CHAIR: I think that's until 12.15.

MR MLADENOVIC: 12.15, is it? Okay. In the afternoon from 1.00 until 3.00 p.m. we have Vector Networks and then again from 3.15 p.m. until 4.00 p.m. Vector Networks. From 4.00 to 5.00 p.m. we have scheduled Jardine Lloyd Thompson.

CHAIR: And the current situation with Marlborough Lines?

MR MLADENOVIC: The current situation with Marlborough Lines is we're trying to reschedule Marlborough Lines to appear on Monday. Unfortunately the presentation is stuck down in Blenheim due to the weather, so Ken Forrest is here but the Deputy Chief Executive is still in Blenheim.

CHAIR: But at this point we haven't figured out the time for Monday?

MR MLADENOVIC: We are working on that now and we will come back to that later.

CHAIR: Okay, thank you for that. Are there any questions anyone has on the revised schedule for the hearings? (No questions).

I would just like to thank everyone for assisting with the changes to the venue that we've had to make in order to keep the proceedings going. I apologise that we don't have a great deal of room here but hopefully we can make it work as best we can.

I would now like to welcome PricewaterhouseCoopers on behalf of the 21 lines businesses that it is representing. As is the custom, I would ask that you introduce yourselves for the record and would ask that you do a brief summary, after which we will then have questions for you from the Commission members and staff, and of course our external adviser.

So, please, when you're ready, we will try to keep the questions during the presentation to a minimum because it is a little more difficult by video conference.

MS TAYLOR: Okay. Thank you very much. We are having a little trouble hearing you clearly. I wonder if it would be possible either to improve the volume a little, or perhaps just speak a little louder, Paula.

CHAIR: Okay. I've moved the mike, does that help?

MS TAYLOR: Yes, that is better. Thank you.

CHAIR: I will just try the volume on our side. Is that any better?

MS TAYLOR: Yes, that is better, thank you.

Good morning. My name is Lynne Taylor. I am a Director with PricewaterhouseCoopers and I am representing the group of 21 lines companies which support our submission.

Sitting alongside here me this morning is Graeme Pinfeld, who is a partner with PricewaterhouseCoopers, with experience in assurance services across the energy sector and particularly in information disclosure for lines businesses.

Also assisting us this morning, but located in

Wellington, Mr Ken Forrest from Marlborough Lines, who very generously offered to come and support the submission today.

MR FORREST: Good morning.

MS TAYLOR: The group of 21 lines companies that we're representing currently represent about 30% of the points of connection or customers across the sector and has between them about 45% of the total line length.

As in previous submissions, it's important to note at the outset that some of the members who do support this submission have also made their own individual submissions of particular points of interest, and some of those I understand have already presented to you and others will be later on during the conference.

In terms of our presentation this morning, I would firstly like to focus on the information disclosure discussion paper before moving on to the valuation choice paper.

Our presentation is focused on the key points of principle in our written submission. We were not proposing to present on some of the more detailed information but we would be happy to take questions on any component of our written submission at any time this morning.

So, into the information disclosure submission. Firstly, in terms of the statutory framework, we do believe that there is value in the disclosures that have been made in the past, particularly following the enhancements that were made to them around 1999 and following the implementation of the Energy Reform Act and the separation of retail for distribution businesses.

For that reason, we believe the existing disclosure requirements are a valid starting point for the current review, although we do acknowledge that there are needs

for some modification to meet the requirements of the Act.

We would also like to take this opportunity to restate a key point that we have made in earlier submissions, that this group of lines companies would welcome the continued focus of the regulatory regime on the outcomes that are most relevant to consumers; that's price and quality. As I say, we have made this point to you before.

There is a concern that there will be increasing costs of compliance associated with indicators or information not directly relevant to price and quantity, and at the end of the day the consumers will bear the cost of these compliances.

We also note that the 2000 Ministerial inquiry into the energy sector recommended that performance indicators should focus on outputs for consumers and they termed those price, availability and quality of supply. That's a recommendation that we endorse.

The third point I'd like to make in terms of the statutory framework is that the regulatory regime for lines businesses has been considerably strengthened from the original light-handed information disclosure regime with the introduction of the threshold components of targeted control regime.

Therefore, it's important to recognise this when defining the information disclosure requirements. That is, information disclosures not required or anticipated to fully meet the requirements of the purpose statement and neither is the targeted control regime.

The final point I would like to make in respect of the statutory framework is that the purpose of sub-Part 3 is to promote the efficient operation of markets directly related to electricity distribution and transmission services, not other services that may be offered by owners

of these businesses.

There is some concern at inferences within the disclosure paper that it may be necessary to consider information from the businesses outside of these core monopoly services. Our point is that if the disclosure requirements can be implemented to ensure sufficient accuracy and consistency over the information that is disclosed, there should not be any need to refer to information outside of these core activities.

I just turn over to the next page now and focus on the objectives, principles and information needs, as presented in the information disclosure paper.

We do believe that widespread disclosures should not be implemented as a substitute for well thought out and targeted disclosures.

It's important that lots of data is not gathered but simply more targeted information is required and this will assist in reducing compliance costs.

In order to achieve this, we believe that the current review should focus on the outputs or the indicators required to meet the purposes of the disclosure regime. In particular, those outputs or indicators required to reset the thresholds at the next regulatory reset and to enable the Commission and other users to undertake some monitoring of the performance of the lines companies.

Following this, it will be appropriate, once the outputs are determined, to define or derive the guidance and the specific information requirements and then to setup and implement appropriate and robust review, certification and audit processes. This should give people the assurances that they require over the quality and the consistency and accuracy of the information.

In addition, compliance costs will be minimised if consistency with other reporting requirements can be

achieved. And by "other reporting requirements" I am referring to generally accepted accounting principles and IFRS, as it's on the horizon for most businesses now, and also the requirements of the Ministry of Economic Development and the Electricity Commission.

Disclosures can be supplemented by further company specific information in the instance of a breach of any one of the thresholds. We are concerned that the information disclosure regime is not set up to provide information for post-breach inquiries which may more usefully be provided by an individual company at the time of the breach.

Finally, we do believe that consistency in information disclosures between businesses is of primary importance and we do believe that this can be achieved with appropriate guidance and prescription, and we recognise that this may involve more prescription and guidance than is currently available through the existing regime.

In terms of financial information requirements, we agreed with the Commission's assessment that financial information will be required to reset the price path threshold for benchmarking and monitoring and that the Commission will wish to use this for initial considerations of breaches.

But we do believe that it's not possible to determine what financial information is required until the outputs, particularly for the price path reset, have been determined.

And it may be that full financial statements are not required, as proposed in the discussion paper, and that a more condensed version of financial statements may be appropriate.

We do not, however, agree with the proposal that

reconciliations and working papers be disclosed. We believe this is costly, overly intrusive and ignores the value of the independent audit of financial disclosures.

Auditors will undertake their own reconciliations and review working papers and users of information disclosure should be able to rely on the audit process in this instance.

We also do not support the proposal that suggests that projections of financial information be disclosed. We can't understand how these could be useful in the regime. They would be subject and likely to change over time.

We think it would be difficult to get directors to certify or approve the forecast and certainly auditors would be unwilling to certify them.

Key forecast information is already presented in asset management plans in respect of capital expenditures, maintenance and growth forecasts. We believe that this is the most appropriate place for disclosures of useful projections.

In terms of the level of prescription around financial statements, we believe this should be sufficient to achieve the consistency and accuracy objectives of the regime. It may justify more prescription than is currently available through other external standards, such as accounting principles, but this prescription may not necessarily be inconsistent with financial standards, for example.

Financial standards are not derived on an industry specific basis and, therefore, it's relevant that industry specific regulation may wish to provide for specific guidance.

But in terms of compliance costs, it would be helpful if the industry specific guidance for regulation was able

to be consistent with things such as GAAP.

If parallel systems are required to be maintained by companies, for example, in terms of key financial information and calculations, such as capital expenditure or depreciation, then this will significantly increase the compliance costs.

We do support retaining the avoided cost allocation methodology as a valid approach for determining financial statements. It is a methodology that has been used across the sector now for a number of years, but we do recognise that there is a need for additional guidance on how this could be applied.

We note that the discussion paper notes some concerns about the incentives around using the avoided cost allocation methodology, particularly in terms of inhibiting efficiency. One of those concerns refers to efficiency in markets outside of distribution and transmission which, in our view, is outside the scope of this particular view. But also I think it's important to recognise the efficiency incentives that do exist in the price path threshold itself.

We also note the discussion paper's concern with the allocation of common costs, where businesses may operate more than one monopoly, and we agree there needs to be some guidance around these particular costs and that as a rule there should not be double accounting across different businesses.

In our written submission, we provide further thoughts on some of the more specific financial components of assets, liabilities, revenues and costs. We weren't proposing to go into each of those here this morning, but perhaps if you have particular questions on those we could deal with those later.

In terms of the valuation of the regulatory asset

base, we do broadly agree with the Commission's assessment of the role of valuation in the regime, and the definition of the regulatory asset base.

We do appreciate that system fixed assets require specific consideration, and, as borne out with the ODV methodology, we're already partly well on the way to that, but in terms of the remaining asset base, we can't see that for disclosure purposes there's any justification moving away from generally accepted accounting principles, in terms of the way that other assets are treated for disclosure.

It may be appropriate in a breach inquiry that further investigation is made into these items but it would be our recommendation that GAAP principles are used for non-system fixed assets at least.

This will greatly minimise potential compliance costs and the non-system fixed assets are relatively immaterial in the scheme of things.

We believe that the most important guidance in terms of valuation will be around the annual valuation reconciliations report, which we believe should be maintained and should be disclosed on an annual basis.

There needs to be specific guidance around how revaluations are stated, and there may be value in stating revaluations by their various components of the drivers that make up an annual revaluation. And there may need to be more guidance around how some of the other items are disclosed. For example, acquisition of networks has been a factor which has confused reconciliation statements in the past.

In addition, in terms of guidance and process, there needs to be some provision for how the valuation handbooks will be updated, over what period and what the appropriates would be, and that would be helpful for users

of the disclosure information and the company preparing it themselves.

The remaining issues and principles around valuation we will address when we get to our submission on the valuation choice paper.

In terms of performance measures and statistics, we recognise that the Commission is intending to do more work on the specification of these over the coming months, and we would just like to offer our assistance with this over this process. We would be more than happy to help where we can with specifying performance measures.

In terms of the return measures, we agree with the discussion papers proposal that ROI is a preferred return measure over the return on equity and the return on funds measure, but it's important to state at this time that that is only - should only be used as part of a wider set of disclosures and measures, and also that returns must be assessed over time.

We do agree that further work is required to define useful, productive and dynamic efficiency measures, and we haven't yet undertaken a significant amount of work in this area. In our paper we have included some initial suggestions about the things that may be considered in this context but, as I said, we'd be happy to work with you further on that.

We do support continued disclosure of what's termed as "technical efficiency" and "statistical information". We think this is particularly important as a time series showing movements over time, and it's already currently widely used across the industry in terms of the disclosures that have been made to date.

I think it would be a shame to lose some of that time series if the requirements were to change markedly, particularly on the statistical information.

There is certainly a need for more guidance on calculating reliability statistics which would improve data quality and also audit processes.

You're probably aware, we had the joy of having to audit reliability statistics last year for threshold compliance statements for a number of companies and it certainly wasn't straightforward. There isn't any formal guidance available at the moment about how this information is to be collated within the companies, and therefore it's very, very hard for an auditor to sign off on this information.

In addition, the form of the audit certificate around reliability information needs further consideration. Currently auditors sign, in effect, a true and fair opinion against GAAP for financial information, but that form of opinion is not appropriate for non-financial information that isn't supported by the equivalent to GAAP. So, that's something we would like to perhaps work with you further on, as to what would be appropriate in terms of a form of an audit sign off on reliability information.

The discussion paper suggests that there may be justification in companies disclosing information by end use customer type, and by "end use" I mean domestic or commercial or industrial consumer.

This, in fact, is very difficult for network businesses now because they don't have access to this information, it's retained by retailers.

What network users do know is where customers are located and what their installed capacity is or their load is, and it may be that different customer groupings are more relevant.

However, it will be very difficult to get consistency in customer groupings across networks, and one only has to

look at the range of tariff schedules that companies currently produce to see the diversity in the way that companies currently group and categorise their customer base.

In terms of reliability, however, there's been quite some discussion on whether or not reliability within a network can be broken down, and I see a number of submissions have already addressed this and also those from the retailers representing customers in terms of a wish to disaggregate reliability somehow within a network.

There has been a suggestion that reliability statistics could be disclosed by feeder. I think that that would generate significantly more information than anyone would ever want to deal with, and it may be that some grouping of feeder is more appropriate.

We did a little bit of investigation into this probably, now, 18 months/two years ago when the Commission was looking at the form of the thresholds, and it seemed to us at that time, although there wasn't perfect information available, that it would be a possibility of grouping feeders by some form of urban/rural, remote/rural categorisation that could be helpfully applied across the industry in a consistent way and that this may be a way of breaking reliability within networks down to something that's more meaningful.

As I say, I don't think the information is available for everybody at this stage but it certainly would be worth looking into.

I suppose the comment is, "if this was easy it probably would have been done by now", but it's not necessarily a meaning not to give it a go in the first place.

I just wanted to move on briefly into the auditing, certification and statutory declarations processes.

We do think that the Commission and users of the information, disclosure information, should place considerable reliance on the audit process to meet the robustness and the consistency objectives of the regime, and that this should allow a design of a regime which hopefully is efficient and can be reasonably cost effective in terms of minimising compliance costs.

In order to do this though, sufficient guidance does need to be provided to auditors to enable them to undertake their work, and I think there's general recognition that auditors would like more guidance and perhaps more prescription than there is available at the moment under the current regime.

We do believe that auditors can review quality data, as proposed in the discussion paper, and I've already alluded to some issues around the form of the audit certificates in relation to quality data.

But auditors must have the appropriate experience and expertise in order to do this, and there may be instances where auditors have to rely on other technical experts to help them in this role.

This is similar to the reliance of auditors already currently placed on other technical experts. For example, in ODV certifications.

We do believe that the current certification and statutory declaration requirements are reasonable. We note that some of the submissions have raised an issue which suggests that perhaps some of the certifications could be provided by management, rather than directors, and that this was a requirement under the Ministry of Economic Development, under the previous regime, and this is certainly an issue that we would be comfortable exploring further as the details are further worked out.

Finally on the disclosure paper, just two final

points. The paper proposes that information for the 04/05 year will be required to be disclosed under the current timetable by the end of August 05 and then once the valuation work stream and decisions have been finalised, that those components of disclosure which reflect valuation assumptions will then be required to be redisclosed and reaudited later in the year.

I just put to the Commission whether or not there may be an opportunity to avoid this rework by either delaying the disclosures timetable until after the valuation work is complete, and that would be similar to the process that occurred last year where disclosures were delayed until after the ODV valuations had been undertaken; or, alternatively, by delaying the restatement of the valuation indicators until the 05/06 year. It just seems if we can avoid having to prepare and audit some information twice this year, it may be helpful.

The final point I wanted to make on the disclosure paper was, we acknowledge the Commission's intention to hold and undertake workshops with interested parties over the next few months to further promote and develop the information disclosure requirements and we would be more than happy and willing to contribute to those at the appropriate time.

I just move on quickly now and cover the submission on the valuation choice paper. The first point is a point I know that many in the other submissions have made, in that the question that comes to mind is whether there is sufficient rationale for valuation choice for lines businesses in terms of allowing both an ODV revaluation and an indexed historical cost option for valuations moving forward.

There doesn't seem to be, to us, sufficient justification for those two methods in the valuation

paper, and the paper particularly went to great length to demonstrate that the two valuations would generate outcomes that were not dissimilar, that were comparable.

It may be that the regime would be significantly simplified if there was no valuation choice and that ODV was adopted as the valuation methodology going forward.

I also note and recognise in some of the other submissions, in particular the Electricity Networks Association who I understand you heard from yesterday, put forward a view that said that, well, instead of indexed historical cost, then perhaps an unindexed historical cost option, which presents a different risk profile for investors, may be an alternative option. That's something we as a group haven't thought a lot about but maybe we should.

So, I just want to put those issues before you before I address the remainder of our submissions on valuation choice where we have considered the two options put forward in the valuation choice paper.

The group of lines companies that we are representing today are very keen that we make the point to you that lines businesses are not in the business of making inefficient investments and there is, I think, for some of the readers, a tone through that valuation paper that companies do make inefficient investments and therefore need to be regulated around that.

The key point that this submission group would like to make is there is already scrutiny from shareholders and consumers on investment plans and investments that are made by the businesses.

There is a requirement for these businesses to operate as successful businesses, and I think it was well demonstrated in the ODV revaluations that were undertaken last year, that the optimisation of the existing asset

base across the industry resulted in 2.2% of value being optimised out.

When you consider that most of that investment was made some time ago, and when you look into the reasons underlying those optimisations, there's very little of that investment that could have been avoided at the time that the investment decision was made. And I just use that as an illustration of the point that companies don't believe that they are making inefficient investments.

In terms of the valuation choice process and procedures, in a similar vein to our submission on disclosure, it would be helpful, in terms of minimising compliance costs, if valuation rules were not inconsistent with GAAP and one area, for example, for consideration is how assets are to be categorised for regulatory reporting purposes, and the ODV handbook has been put forward as a possible categorisation tool to use.

This is helpful because this is something that can be achieved which would be compliant with GAAP and would avoid companies having to maintain duplicate underlying asset registers. By "underlying", I mean source information about accounting and aging assets and that's where the cost in the work is, in terms of compiling asset registers. Although these may be valued differently for different purposes, it's helpful if the categorisation and the physical asset register can be maintained.

In terms of updating valuations, which is a key component of the discussion paper, we do support the Commission's intention that companies update their valuations annually and that they disclose these in an annual valuation reconciliation table, but we also agree and support the intention that this be done for some years anyway by the use of estimates or proxies for revaluations. We think this will significantly minimise

the compliance cost and is acceptable as part of information disclosure.

Our suggestions are that ODV valuations be revalued at least once every five years, more often if a business elects to do it, for whatever reason, and more often if the network changes materially.

Now, the current disclosure requirements require revaluations to be made within the defined revaluation period if system lengths and/or capacity change by more than 10%.

If the valuation period is extended from three years to five years, then it may be that 10% needs to be changed as well. And one of the submissions, I just can't recall which one it was, suggested perhaps a benchmark of 15% for materiality.

In order to implement that revaluation timetable, it will be necessary for the Commission to provide some guidance on when and how the ODV handbook itself will be updated.

I am just not sure, it's probably one of the details that can be worked out further down the track, I am not sure whether or not it is the intention of the Commission to have the valuations updated before the work is undertaken on resetting the price path next time and maybe five years is too long, that initial recess.

In terms of the ODV in the interim years, we suggest that additions are rolled in at cost. We believe this is acceptable and any overs and unders that would be resulting from applying the full ODV methodology can be caught up at the five yearly revaluation.

We also accept the proposals that the underlying valuation be indexed in the interim years.

If an indexed historical cost valuation methodology is adopted, we think that it is acceptable for prudence

reviews on additions to be made at the same time that an ODV valuation will be undertaken by those choosing to use ODV. That would be at a minimum once every five years on an ex-post basis, but also more frequently if a company wished to, or if there was a material change in the network within that period.

Additions should again be rolled in at cost, subject to the periodic prudency review, and again rolled forward using the same index as would be applied to ODV in the interim years.

In our submission we have put some thoughts about what that index may be. I appreciate there isn't a readily available index which reflects movements in asset costs. We don't believe it should be the CPI, which measures movements in household prices, and it may be that some proxy of the labour cost index or the capital goods price index may be appropriate.

Those were the key points that we wanted to make this morning on the valuation choice paper and also earlier on the disclosure paper. So, that's the end of our formal presentation to you.

CHAIR: Thank you very much for that, Lynne. It's a very clear presentation and we are grateful to you for that.

I would just ask Ken Forrest if there was anything he would like to add before we go on to questions?

MR FORREST: Not at this stage, thank you.

CHAIR: Lynne, I'd like if we start questions in the area of the purpose of disclosure and I'll start by asking a question and then ask my colleagues to join in on that point.

In the PWC submission on behalf of the 21 lines companies, you talk about the primary objective of the disclosure regime being to consider electricity distribution and transmission services, and I certainly

understand that point, but I would like to ask you whether you would acknowledge the possibility that information on other aspects of a lines company's business might be required in order to support that primary objective?

MS TAYLOR: Our initial response to that is for the purposes of disclosure we're not sure that that is the case. It may be that for the purposes of a post-breach enquiry, that that is justified, but for disclosure purposes we believe that if the requirements are prescriptive enough, and if the audit processes are robust enough, there may not necessarily be the justification for information for operations outside that core business.

CHAIR: Can I just follow that up a little bit because I notice that you're focusing on the disclosure aspect of this, and we indicated yesterday that it may not be necessary for the information to be disclosed as part of the disclosure regime, but the Commission does have an obligation to monitor compliance with the disclosure regime and as part of doing that, it may require information on the businesses outside the distribution transmission business in order to ensure that the disclosures are being made in the way intended.

Now, I hear you say that the auditors will, of course, do this, there will be some reconciliation that goes on, and they will check to see that whatever prescription is provided is complied with.

But if they're doing that, it doesn't seem onerous that the Commission requires as part of its monitoring compliance with the disclosure regime, if we require information on this, and I do think it's absolutely valid to say that that information should not necessarily be publicly disclosed but, nevertheless, the Commission may need to do it as part of monitoring compliance with the disclosure regime. Can you comment on that?

MS TAYLOR: Yes, I do accept that point, that the Commission may need additional information to assist it in its monitoring.

It may be that there would be instances where the Commission would require specific companies to provide explanatory information on working papers but I'm not sure whether or not that requirement would be a widespread requirement on everybody for every year of disclosure.

CHAIR: Why is there a large compliance cost of providing it as part of the monitoring process if the auditors are doing it anyway? What is the additional compliance cost?

MS TAYLOR: Anything that is provided externally, as a compliance cost - I take your point that the auditors will be looking at such information as well. I suppose one of our concerns is that too much data may not provide a lot of information, if you see what I mean.

It seems to me that if the disclosure requirements can be adequately determined and ascribed, then in the first instance that information which is publicly disclosed should be sufficient, and that if there are any concerns or questions that the Commission may have in its monitoring, then it would be appropriate to go back and ask for clarification, in a similar way that the threshold compliance statements that come to the Commission have a certain specified information contained in them and, as I understand it, from time to time the Commission has asked for additional information to support their understanding of those.

CHAIR: I suspect that that works in a very similar way to how the monitoring process would work with the information disclosure.

I think Commissioner Bates might have a follow-up question.

MS BATES: I am just wanting to clarify with you what your

attitude is on what I will call the "reconciliation information", that's reconciling the statutory accounts with the regulatory accounts, do you think that it would be appropriate to publish a statement of how the reconciliation was achieved?

MS TAYLOR: There are two parts to my response. The reconciliation to statutory information, until we've actually determined what financial information will be disclosed, it's sort of hard to comment on what the form of those reconciliations may be.

Secondly, we don't support the public disclosure of those reconciliations. We believe it should be adequate for the auditors to review the reconciliations, and certainly in discussions with our auditors, that they will undertake a line-by-line reconciliation to statutory information when they are auditing the information disclosures and that that should be part of a standard audit process and we, therefore, don't believe or support the public disclosure of that information, although I accept going back to Paula's previous point, it may be that the Commission may wish to look at that information at some stage.

MS BATES: Yes, and she's canvassed that and that's our powers under 57U in our monitoring role.

MS TAYLOR: Right.

MS BATES: Just let me put this to you, and it's just by way of clarifying and getting your response to it, under 57T(2)(a), the Commission must require large lines owners and large electricity distributors to disclose information concerning their business as a line owner or electricity distributor. I put it to you that reconciling the statutory accounts with the regulatory accounts may well come in within that definition as being information concerning the electricity business, because it's how you

get there, if you see what I mean?

MS TAYLOR: Yes, I understand the point and I understand the way it was put forward in the discussion paper as well.

I suppose our key concern is we would like information that is publicly disclosed to be that which is the most useful to users and that which is targeted to be the most benefit to the purpose statement in the regime. I accept that the Commission may wish to look at other supporting information but we do believe that because the regime - the primary purpose is to focus on electricity distribution and transmission services, that it's that information that should be disclosed.

MS BATES: Let me take you back to the overall purpose statement - sorry, did you want to say more? I didn't mean to cut you off there.

MS TAYLOR: No, that's fine.

MS BATES: Which is to give a wide range of people, and this is really paraphrasing from 57T(1), information about factors such as profits, costs, assets values, price, and then there's the quality service ones.

Well, you've asked that we focus on the quality service ones but, in fact, there is an obligation for us to go beyond that and to profits, costs and assets values. For some of those things then reconciliation information would seem to me to be quite useful in informing the public as to how the costs were arrived at?

MS TAYLOR: Well, I'm not entirely convinced they are useful for informing the public. I think the information that's currently disclosed is challenging enough for the public and I think that if there is sufficient - what's the word - confidence in the information as it is disclosed then there should not be need to public those reconciliations.

MS BATES: So, you think the public doesn't need to know about

it?

MS TAYLOR: I think the public should have confidence in the information that is disclosed around assets, liabilities, revenues and costs.

MS BATES: But taking the Chair's point, you can appreciate that in its monitoring role that reconciliation information may be required to carry out that role properly?

MS TAYLOR: It may be but I'm not entirely convinced that it may be required for everybody every year. It may be that it's required as further explanation on a case-by-case basis.

MS BATES: There would be the power to require - the power is there for the Commission to require every year if it wants to?

MS TAYLOR: Yes, I accept that.

MS BATES: Okay. I just wanted to ask you something that you said - about something you said on page 2/page 3, it's under "information disclosure", the point is you say:

"Widespread disclosures should not be implemented as a subject for well thought out, targeted disclosures."

I wasn't quite sure what you were meaning there, maybe others were, but it might be helpful if you elaborated on that and, say, give us an example to explain.

MS TAYLOR: Yes. The point is, and I apologise for not articulating it very well, was that there is a risk of disclosing a large quantum of data which doesn't actually provide a lot of information, in terms of it's not readily understood.

One of the examples, I think, currently under the reliability disclosures, there's a lot of information around targets for performance indicators across various causes of interruptions, and it may be that these could be

reduced to two or three key pieces of information to be disclosed, rather than, you know, 10 or 12, and that was really my point. That was really my point, if sufficient thought is put into specific needs, specific disclosures, it may be that the quantum of disclosure information can be minimised.

MS BATES: Yes, I do understand what you mean. I just draw your attention to 57V, it says that the summaries that we and analysis that we, the Commerce Commission, are to publish, has the purpose of promoting greater understanding of the relative performance, and I suppose that's the point you're driving at, is information that is meaningful and helps people to understand?

MS TAYLOR: Yes, exactly, yes, exactly, because, as you appreciate, there's a lot of sort of technical information about these businesses which is not readily understood unless you've been involved in the businesses themselves, and I think, perhaps, by focusing on those that, to use your words, are more meaningful, then perhaps some of the objectives can be more easily met.

MS BATES: Yes, I caution though the purpose statement is that this information is to go to a wide range of people, so it's not just consumers, it's probably other businesses themselves that are interested in each other's information, so you can't have it too - you know, not enough detail?

MS TAYLOR: Yes, that's true. I suppose the best example now thinking about it, is the current disclosures of financial statements have a large number of expenditure categories which are disclosed. The discussion paper refers to these and suggests that maybe some change could be made here. I think that there's very little, as far as I'm aware, very little use currently made of all those various expenditure categories, partly because there's not a lot of confidence

in terms of the comparabilities between them. They don't seem to add a lot of value to the regime at all.

MS BATES: Thank you very much, Lynne. I will pass over to others now.

CHAIR: I think, Ken, you might have wanted to ask something earlier and I want to give you that opportunity, but I think we need to move a microphone for the tape recording. Do we have another one of these?

MR MLADENOVIC: Can you just test that out.

MR FORREST: There are one or two comments I would like to make, if I may. Is the sound system working?

CHAIR: Can you hear, Lynne, when Ken speaks?

MS TAYLOR: No, we can't.

CHAIR: Do we have more of these mikes?

(Microphone passed to Mr Forrest)

MR FORREST: I would like to make a couple of brief comments, if I may.

First of all, in relation to regulatory and statutory accounting requirements, for our part I think it's important to seek alignment as far as practicable.

In our own case, at one stage we had our accounts qualified by the auditor because we complied with the regulatory requirements, but that was in breach of the statutory accounting requirements in respect of consolidation and we had our accounts qualified as a consequence of that, and then there was one person who suggested that the company had acted improperly because its accounts were qualified, and we would rather not have that sort of thing.

So, we would like to see consistency between the two and we concur with what Lynne has said in terms of provision of information that may cloud or obscure the main issues.

Can I just make another comment in relation to what

the Chair said earlier in terms of the provision of information other than that related to the distribution and transmission businesses. We would be concerned if that other information were to come into the public domain because we are in the area of contracting, and I know other network companies are, and there's one of the members of this group which PWC is representing that has its contracting business as a much larger entity than the network business, and contracting is in a competitive environment and we wouldn't want information disclosed to our competitors. But we would be very happy to make all our information available to the Commission if it required it in terms of an investigation.

CHAIR: We addressed that yesterday, Ken, and we certainly acknowledge that commercial information, such as that, should not be publicly disclosed and we don't have difficulty with that.

MR FORREST: Thank you.

CHAIR: I am not even sure, I think our powers to require information such as that comes through the monitoring of compliance with the disclosure regime, rather than as part of the disclosure requirements itself.

MR FORREST: Thank you.

CHAIR: Any further comments, Ken?

MR FORREST: No, thank you.

CHAIR: I will just check with my other colleagues if they'd like to pursue these issues at this time.

MR TAYLOR: I just had a couple of points. You can hear me up there?

MS TAYLOR: Yes, I can.

MR TAYLOR: On page 8 of your presentation you talk about providing auditors with sufficient guidance to ensure consistency. I wonder if your colleague, who probably has experience in this area, would be able to give us some

idea of the sort of areas a greater prescription would be of assistance.

Where I am going with this is following up on the point that over time we would want to gain experience in the sort of areas that consistency - we would want to get experience so that over time the accounts became more comparable based on consistent presentation in order for our people to be able to get that experience, the sort of information that would be included in the reconciliations between the statutory accounts and the regulatory information is the sort of information we need to get the experience ourselves, to give the guidance that you need. Do you see the sort of circle I'm painting?

MR PINFOLD: Yep, I do. It comes down to, and I am just trying to think of some examples, but providing a level of guidance, if I can contrast it to looking at GAAP and how we would audit financial information for statutory purposes.

GAAP provides a framework by which we measure, or the companies measure, and we form our opinion on the presentation of information around that.

Companies supply different policies to certain things in their application of it it's really at a level of guidance around application of the policies. I am just maybe looking at the avoided cost model, for example, and perhaps how guidance around that to ensure the point was raised around double counting, how specific that is in the way in which the companies should apply that model and be able to present their information with it.

Lynne, I was just going to ask, can you think of any specific areas that we can use as an example?

MR TAYLOR: I understand where you're going with this, and it does seem to me that the guidance you seek would be very informed by the reconciliations, albeit non-publicly

disclosed that we're talking about.

MS TAYLOR: I think the issue with the reconciliation is that it sort of comes partly after the fact.

I mean, in terms of generating the financial statement, currently the only guidance that is offered is the requirements themselves and a reasonably short handbook, which presents some principles but doesn't focus on specifics, and it's those specifics that, sort of, concentrate the mind, if you like, at audit time about what's reasonable and what's not in terms of the principles.

I think that there probably are maybe only a small number but a number of particular areas where it would be advantageous to the regime to have some common approach.

MR TAYLOR: Oh, I agree with that, yeah.

MS TAYLOR: And that's the kind of thing that would make the auditing a bit easier.

MR TAYLOR: I understand. I think we've routed round there a bit.

Can we move on to your comment about management certification. It would be a normal proposition, I would have thought, that when a company makes a certification to an outside body the directors would be the normal people who make that certification, albeit based upon internal representations.

I wasn't quite clear why you were suggesting, or it was being suggested by your clients, that management certification should be accepted, particularly on the basis that directors give the certification presumably based upon some form of internal governance review and internal representation, all of which gives a body such as us more confidence that the proper inquiry has been followed through.

MS TAYLOR: I accept that and I accept that that is the

standard procedure. I think the comment came more from the fact that previously under the Ministry of Economic Development regime, some of the certification which is currently provided by directors was provided by management, and I would just have to go back and check the old regulations to see what that was.

I think some of the companies were wondering why there was the change and if it was acceptable previously, would it not be acceptable now? I think purely from a logistics point of view, sometimes it's just easier to do it that way, but I would just have to go back and refresh my mind about what it exactly was that the management were certifying and how material that was in the scheme of things.

MR TAYLOR: But you are not disputing the general proposition I am putting to you?

MS TAYLOR: No, no, no. No, I'm not.

MR TAYLOR: Thank you. Okay.

MS BATES: Just taking up the discussion you were having with Commissioner Taylor around specifics that you thought might be useful, I think it would be useful to us if perhaps in the cross-submission period you gave some more thought to that and perhaps came back with some discussions.

MS TAYLOR: Yes, I would be happy to.

CHAIR: We are just asking, Lynne, that people come back by the 5th of April, the time of the cross-submissions.

MS TAYLOR: Okay.

MR TAYLOR: And just to finish off with a, sort of, feedback, to my understanding of what was being said was that you were confirming, correct me if I'm wrong, that the companies would, in the normal course of events, have some form of reconciling process between the statutory accounts and the regulatory information accounts, and that you

didn't think -

MS TAYLOR: Yes.

MR TAYLOR: Sorry? The question was merely whether that would be disclosed?

MS TAYLOR: As I understand it, with the current disclosure requirements, the financial statements, there is typically a reconciliation statutory account.

MR TAYLOR: Okay.

MS TAYLOR: I can't say if that would be the case going forward because that will depend on the financial statements requirements that come out of this review.

MR TAYLOR: Of course.

MS TAYLOR: And, sorry, the second part of your question was?

MR TAYLOR: I think that's probably -

MS TAYLOR: Is that it?

MR TAYLOR: Yes, I think that's got it, thank you.

MS TAYLOR: Okay.

CHAIR: Lynne, maybe we'll go on to another area and talk about the issues around disaggregation of disclosed information.

You have talked a little bit in your presentation about the issues around customer class and also by disaggregating quality information and you address the issue around feeder or some other aggregated form.

One of the issues you haven't touched on relates to disaggregation by sub-network, which we have raised with other parties. I would like to ask whether your group of 21 companies have discussed this issue and, if so, what their view is?

MS TAYLOR: No, to be honest it's not an issue that has been raised within the group. I am happy to go back and raise it with them and come back on cross-submission but, no, it isn't something that we've explicitly discussed.

CHAIR: Okay. I'd be grateful if you did. I think it does raise important issues in terms of comparisons between

companies. And one of the issues that we raised with Unison yesterday is, is it a valid concern for the Commission to have, or the public to need to know, if companies, perhaps because of historical events or acquisitions and mergers, that possibly in some sub-networks they're earning much higher returns than in others?

It's a particular issue, I think, potentially where you have companies where the shareholders are the consumers in one sub-network and not in another, and should we require information disclosed to allow us to understand what's happening between the sub-networks and to consider whether there's any cross-subsidising going on between them.

So, I think we would be very grateful for the input of your members.

I would ask whether you have a view on this as an expert in the field. Is there any comments you would like to make?

MS TAYLOR: I would like to come back to you on that as well.

CHAIR: Okay. We just ask that you do that as well by the 5th.

Ken would like to make a comment on this and I will just turn to him now.

MR FORREST: Can I just say that currently there's a number of networks in New Zealand that at a snapshot in time and if we go back to the 1950s there were in excess of 80, at the beginning of 1990 there was 61, now we've got in the order of 27, and I think as time goes on the number will continue to diminish.

I don't think there's anything magic about the current number. Over time, as there is rationalisation and aggregation within the industry, it might be or might not be cost effective to continue to provide information based on what it was, say, in 2005. I don't think there's

anymore magic about 2005 than what there was in 1990 and continuing to keep information separate may ultimately lead to inefficiencies and a matter of keeping costs separate.

CHAIR: I certainly understand that point and the Commission doesn't want to give the impression that we have any difficulty with further - we wouldn't give a blanket approval to any further mergers and acquisitions but, clearly, there's strong efficiency arguments for some further movement in that area.

However, what we said yesterday is it does seem likely to be a valid concern, may be a valid concern, that the Commission consider whether - this is a matter of degree and if, for instance, we find that the network, one sub-network where the return is 5%, just as a hypothetical example, Ken, and that network is owned by - the owners of the whole network are the consumers of that particular sub-network, and the other sub-network that's owned by that group, if the return in that network was 15% compared to the 5% and in the sub-network owned by the consumers in that area, and is that something that is a valid concern under the threshold regime, and is it something that the disclosure regime should provide information on so we can satisfy ourselves that there is a reasonable balance being struck here?

I just seek your view on that. Are you comfortable with the situation where a network is charging on that basis, that yields that result? Would you be comfortable with that? Is that something the Commission should have no interest in?

MR FORREST: I think over time there will be further rationalisation and I think, as networks are aggregated, it's probably better to leave the old boundaries behind. That's my personal view, the old area, because in addition

to returns from the areas, it's a matter of looking at capital expenditure etc., and in the end things will have to be aggregated to maximise efficiency.

CHAIR: Sure. I suspect, though, the issue there is it's fine to treat them as if it's one network if the company running the network is running them as if they are and not cross-subsidising across them.

What happens, Ken, if they are cross-subsidising and they're not running it as if one network and customers are not being - customers with similar costs, underlying costs, aren't being treated in the same manner?

MR FORREST: I guess that could be identified through pricing more than profitability. But there is currently, and I guess there always will be to an extent, cross-subsidisation between customers on any network, any network in New Zealand there is an element of cross-subsidy.

CHAIR: This is a matter of degree. There is an issue of degree here, isn't there?

MR FORREST: There is, I appreciate that.

CHAIR: Okay. Well, I think it would be useful if PWC come back to us on behalf of the 21 lines companies on this point.

You may be aware also that Genesis indicated that there was a significant issue around the possible double dipping on assets, on the return on assets, where power companies use those assets for other businesses as well and they suggested that some of the benefits of that should come back to the consumers of that network.

Do you have a view on that on behalf of the 21 lines companies?

MS TAYLOR: It is not something that we have explicitly discussed either at this stage. But my own view is, I don't believe it's widespread or material at this stage,

in terms of the use of common or shared assets.

It's certainly an issue that we came across on a couple of the valuations that we have done and that was addressed at that time. And it's also an issue that is addressed in the rateable value that companies have to provide to their local bodies, where there is a sharing of the asset values that is -

CHAIR: How did you treat it in the case that you came across it in the audit context? How did you treat the shared assets?

MS TAYLOR: I'd have to check the details. My recollection is that we apportioned the asset; one portion into the valuation and a portion out of the valuation. I would need to just refresh my mind on the details.

From memory, it really wasn't material, it wasn't a material item in the valuation, but I just need to go back and check.

CHAIR: I think it would be useful if you could do that.

MS TAYLOR: Yes.

CHAIR: It is an interesting area and it's arguable that this could be of growing importance. The Commission certainly doesn't want to discourage businesses from seeking out those opportunities but, you know, regulators have found ways to try to leave some incentive there for those gains to be pursued but still ensuring that some of the benefits are returned to the consumers within the line network.

So, if you have any practical advice on that, a practical approach of dealing with that issue if it does become a bigger issue over time, I think that would be useful.

MS TAYLOR: Yes, yes, exactly.

CHAIR: Can I just see if my colleagues have further questions they would like to ask on the issue of disaggregation?

(No questions).

What I would like to do now, if we could, is turn to the issue of asset valuation choice.

I understand the point that you're making and I note that you haven't talked about some of the issues that came up around possibly whether the Commission should look further at DHC, as opposed to IHC, but we did have a little discussion yesterday about some of the comparability issues that arise as a result of going down that path, and the Commission does have obligations under the Act to provide comparative information once we have the disclosed information, and obviously the threshold regime thus far has been premised on a benchmarking exercise that relies on comparisons as well.

I wonder if you have any comments to make about DHC and the implications it might have for comparability?

MS TAYLOR: I do accept your point that it makes comparability a lot more difficult and, therefore, given the requirement, the sort of benchmarking premise that the regime has been designed on to date, that the DHC would not be particularly helpful to that objective.

We haven't thought in any detail about how you would overcome that issue if DHC was to be used.

We weren't proposing particularly DHC as an option that the group has particularly supported, we just acknowledge some of the discussion in some of the other submissions about other alternatives to the indexed historical cost. But I suppose, just coming back to restate our key point, is that given that benchmarking is so important in the regime as it's currently designed, and given that therefore comparable information is very important, is there a need for valuation choice per se?

CHAIR: I think this is an issue we have to give very careful consideration to because the Commission has been attracted to giving companies the choice. There's clearly some that

would like to pursue that choice, or at least they may want to, though there seems to be some backing away from that if it's going to be on an indexed historic cost basis.

But developing a historic cost approach is a costly exercise for the Commission and the industry, and if it turns out no-one is going to use it, it would be better to find that out now rather than later. But it gets a bit circular because if you don't develop the full proposal, how can people make a choice? How can companies make a choice?

MS TAYLOR: Yes, I agree, and I think that's also the feeling of the group that we're representing, is that people are somewhat reluctant to give up an opportunity for choice without first knowing what that choice is.

But the way it's currently specified, and I think some of the criteria that were presented in the valuation paper suggests that the cost benefit of offering that choice may, in fact, not be particularly great.

CHAIR: The other issue that we asked about yesterday, and I think it would be valuable to have your input on, is Transpower's valuation methodology.

I don't know if the group has discussed it or if you have thought about this, but if the Commission were to decide not to allow a choice, for the reasons we've talked about, and we certainly have not come to any view like that to date, but if we did, would there be any harm in, nevertheless, allowing Transpower to use IHC because that's what their preference is at this point?

Are there any arguments against that in the case of Transpower?

MS TAYLOR: I suppose the key principle that needs to be considered in responding to that is whether or not comparability between - or benchmarking between Transpower

and the distributors is an objective, or whether or not it's in fact useful or achievable.

And, I suppose, our, sort of, initial response, and I would like to go back to the group and just confirm this, so I will just caveat my response a little at this stage, is that perhaps there aren't the same drivers for benchmarking or comparability between Transpower and the distributors and, therefore, perhaps there is sufficient justification for permitting an alternative valuation methodology for Transpower if that better suits their needs and your needs in terms of regulation of Transpower.

But, as I say, I would like to go back and test that a little with the 21 lines companies.

CHAIR: Yesterday the Electricity Networks Association made an interesting observation in response to Commissioner Hemmingway's question on this, and they commented that they do have a concern about it because with distributed generation coming on line, the boundary between Transpower and the distribution companies will become blurred over time, one reaching into the other's business, and the other way back.

So, over time this may become a bigger issue as something we should have regard to. So, I would ask you to look at that submission, the oral submission that was made by ENA yesterday because I thought it was an interesting observation.

MS TAYLOR: Yes, we certainly will.

CHAIR: Ken, did you want to comment?

MR FORREST: I concur with the point made by the Networks Association made to you and I think as time goes on there will be similar assets owned by both Transpower and some of the network companies, and I think it would be incongruous if we had a system whereby Transpower was allowed a certain value for those assets, yet the network

companies had a different value because of different methodology.

So, I think we'd have to make sure there was alignment between the two.

MS BATES: I think there was another related point. I think ENA made - who made the point about wanting Transpower to produce disaggregated information by region?

CHAIR: That was WEL.

MS BATES: Was it WEL?

CHAIR: Yes.

MS BATES: Do you have any thoughts on that?

MS TAYLOR: Sorry, was that that ENA thought Transpower should produce disaggregated -

MS BATES: It was WEL, actually.

CHAIR: It wasn't valuation information, it was performance.

MS BATES: I'm sorry, I'm going on to a slightly different tact.

CHAIR: It is a slightly different point but, again, you might want to look at that submission on some of the quality reliability information that Transpower puts out in an aggregate form, would it be more beneficial if it was done on a regional basis, and Commissioner Bates is just reminding us of that point, which is an interesting discussion and we would value the input from your members on that.

MS TAYLOR: Okay.

CHAIR: I think it would be useful now to ask Commissioners if there are other questions, either on this issue of disaggregation or any other matters that we haven't picked up.

MR HEMMINGWAY: I just have one brief one, this is Roy Hemmingway, that is you said you hoped the valuation choice would be consistent with GAAP but you didn't quite say that IHC was inconsistent with GAAP.

MS TAYLOR: Okay. Our technical people have told me that they believe indexed historical cost will not be consistent with IFRS, international financial reporting standards, which New Zealand companies are moving towards because there's no provision for indexation.

Currently under FRS 3, there is a provision for indexation but it's very limited, in that it has to be very asset specific indexation, and we're not sure that the current proposals for IHC would meet those requirements.

As I say, it hasn't really been tested but our initial feeling is IHC would be problematic in terms of complying with GAAP going forward.

MR HEMMINGWAY: Okay.

CHAIR: I would just like, Lynne, now to ask Paul Sell to pursue any questions that he may have. I think you know Paul from previous hearings?

MS TAYLOR: Yes.

MR SELL: Hi Lynne.

MS TAYLOR: Hi.

MR SELL: I just have a couple of, I think, relatively brief questions.

The first one is, you make a statement, and I'm sorry I don't have the page reference in front of me but I'm sure you will be able to find it easily enough, that allocative efficiency objectives would be assisted by more use of current disclosures of contract terms and conditions, lines charges and pricing methodologies.

If you have any brief comments on that now we'd probably welcome them, but I suspect it's probably an area that would warrant a fuller explanation and I'd like to ask for that in cross-submission. If you could just elaborate on what you're getting at there a little bit more.

MS TAYLOR: Okay. I'll go back and have a look at what we wrote and expand it for you.

MR SELL: Okay, thanks.

My second question is probably also just one for cross-submissions. You make a statement, and I have got the reference here for that, page 26, on treatment of tax, where you say:

"Regulatory specifications of tax calculations should recognise the efficiencies achieved by some ELBs in minimising taxation paid and they should not be penalised for this."

Then the final phrase on that sentence is:

"Where these benefits accrue to consumers."

And, I guess my point would be that that final phrase is the crucial issue, do the benefits accrue to consumers, or do they accrue to shareholders? And without certain disclosures, how is the Commission to know?

MS TAYLOR: Okay.

MR SELL: If you could provide a cross-submission on that I think that would be very useful because, as I'm sure you are well aware, that is quite a significant and contentious issue.

MS TAYLOR: Yes, I accept that.

MR SELL: Okay. My next question is about the independence of the auditor in relation to you signing off on system fixed assets because you make a statement, I think it's on page 40 of your submission, in which you essentially support the need for the auditor to be independent. I was just wondering what your view is on the situation where the auditor is also being asked to sign off on the valuation or where perhaps the potential auditor has already signed off on the valuation?

MS TAYLOR: Yes. That situation arose under the Ministry of Economic Development specification of the information

disclosure requirements where they defined "auditor" as a person or an individual as opposed to a corporate, which at that time suited the needs of the regime as it was being developed.

In discussions that we've had with Commission staff over the last six months, where we've been going through that process on valuations, it became clear that the Commission's interpretation of auditor was somewhat different and it wasn't limited to a person, more of a corporate.

And it is our view that this is a more appropriate interpretation at this time and for this regime and, therefore, what that would mean is that it would not be possible or permitted going forward for auditors to certify valuations which had been assisted, or the preparation of which had been assisted by someone else within the same firm.

MR SELL: Okay, yeah, thanks for that clarification.

There's one other question which Mr Ryan and I were discussing earlier in relation to projections, but would you like to ask that question when it comes back to you Paolo, or would you like me to ask it?

MR RYAN: Sure.

MR SELL: I will hold on that, in which case that's all from me.

MR RYAN: Hello, Lynne. Just in relation to the projections, just in your comments I noted the comments that you said that those would be difficult for directors to certify and that auditors would be unwilling to certify projections.

Now, I notice in your submission at page 20 it actually said that it would not be possible for auditors to certify projections.

I am just wondering, I mean, projections are signed off by auditors, you know, all the time. What gives rise

to that particular statement?

MR PINFOLD: Perhaps if I could answer that. In relation to projection, the auditor should, if given with respect to projection, is set around that the projection has been calculated on the assumptions as stated but giving no opinion as to the validity of the projection or the possible outcomes.

So, as applied under, say - the prospectus is in general financial reporting any audit opinion around a projection you will see will state the projection has been calculated based on the assumption it's dated but will not give any opinion about the validity of the assumptions associated with that or an opinion as to the outcome of those projections. So, it's become, say, really a compilation opinion more than anything else.

MR RYAN: To that extent there would be no difficulty in directors and auditors certifying those opinions?

MR PINFOLD: Well, it depends what you mean by "certifying".

If you mean by that an opinion on the validity of the projection -

MR RYAN: Sorry, I mean to the extent that they're calculated on the assumptions stated.

MR PINFOLD: No, that would be consistent with other general financial reporting.

MR RYAN: Thank you. I had one other question, just in relation to the statement that a true and fair opinion was not really appropriate for non-financial information.

Now, I just note that it's common practice to apply this opinion in relation to public sector statements of service performance.

So, is that more a matter that, given the perceived lack of guidance here, you don't feel that that's currently appropriate, or is that a blanket statement that you don't feel the true and fair opinion is appropriate at

all?

MR PINFOLD: It is primarily as a result of a lack of guidance.

If we compare it again to general financial reporting, the true and fair opinion is stated in the context of generally accepted accounting principles, and on that basis that provides the framework in which the auditor gives their opinion, so they can measure the financial reporting against that.

In circumstances where there is not that framework, and if we look at the reliability measures, for example, in the thresholds, there is not the guidance and prescription around that to enable the auditors to provide a true and fair opinion.

What we would see is in a compliance type statement that an auditor offers an opinion on, is more along the lines of fairly presents in accordance with the requirements that set that out, of that nature rather than a true and fair view, which has a meaning and a context under generally accepted accounting principles.

MR RYAN: Thanks for that. I just have one other point, and this is just related to, once again, the reconciliation issue.

In terms of reconciliations, it's not just the practice to compile the reconciling items but to actually look at the validity of reconciling items, and it's certainly been regulatory experience in other jurisdictions that cost allocation in particular has been fertile ground for creative regulatory accounting, is it not fair - I mean, we can certainly consider, you know, giving more specific guidance on that but, I mean, in some sense it's difficult to give precise enough guidance without first understanding the nature of the items that might arise.

Going back to another point you made, Lynne, I think

is it not reasonable then to ask that those be - whether they be publicly disclosed or not - they be provided to the Commission every year for every lines business?

MS TAYLOR: My response to that is similar to what I said earlier, is that maybe that is not necessary if we can provide you with and get sufficient input into the prescription of the requirement over the next few months, and the Commission can gain enough comfort over how it all works in practice perhaps over the first year, following the first set of disclosures, then it seems to me a little premature to build into the disclosure regime now for the foreseeable future a disclosure requirement for full reconciliation to the Commission by every company for every year, and I acknowledge the request from the Commissioners for us to come back to you during our cross-submission for ideas about where prescriptive discussion would add to the value and assist to solve this issue.

DR GUNN: Just a question, Lynne, on indexation. I think I'm outside your screen, it's Calum Gunn.

MS TAYLOR: Yes, you are.

DR GUNN: I note that PWC submits that the concern about CPI is more of a concern for the historic cost rather than ODV, and I am just wondering again if hypothetically the Commission were to decide to perhaps go without a choice and to stick with ODV, and if the replacement costs in the handbook were to be updated, say, every four or five years, would you feel the need for the move to a sort of combined capital labour index would still be required, or would the CPI be sufficient, do you think?

MS TAYLOR: I think I'd probably like to go back and just have a look at the indexes in a little more detail.

I accept that because you have a periodic revaluation it brings the valuation back into line, if you like, and

therefore compensates for any overs or unders in terms of the index versus the movement in replacement cost, that the accuracy in the index is less important than under the indexed historical cost. So, I accept that point.

I am still not entirely sure that CPI is the best we can do but I do accept the point that there doesn't seem to be a readily available alternative at this time.

DR GUNN: Certainly in cross-submissions, I mean, this is an issue of detail that will certainly come up later as well, but if you do have any additional thoughts at cross-submission stage it certainly would be useful, because you will recall the debates about indexation that occurred in the TFP process for the thresholds and it was difficult then looking at the stats series that were available to have a lot of confidence in some of those.

So, certainly any additional thoughts you have would be most welcome.

MS TAYLOR: Okay.

CHAIR: We have one follow-up question, Lynne, from Commissioner Taylor.

MR TAYLOR: Actually we have a couple. I will deal with the first one.

The certification, in your original submission did you propose an alternative to the true and fair words? Your colleague went through the possibility of the type of words that may be possible. If you didn't, perhaps you could think about that and maybe let us have some suggestions in cross-submission.

MS TAYLOR: Yes, except that, Peter, we have in the past provided some words to the Commission staff as the gazettes were being drafted around the current compliance statements, and in particular in relation to certification of quality information, and perhaps we could just expand on that information a little in our cross-submission.

MR TAYLOR: Sure, thank you.

Just to be absolutely clear about what your views are on tax, and I will play back to you how I sort of word what the issue is, which is that for the regulatory accounts purposes the options are either the standard rate or the company's effective rate or something in between.

Could you just come back to me just what your view is with regard to the tax to apply to the regulatory accounts?

MS TAYLOR: Yeah, I'll come back to you on that after I have consulted with the team because there is some discussion about that.

MR TAYLOR: There is and we had a proposition -

MS TAYLOR: If that's okay?

MR TAYLOR: Yes, we had a proposition put to us yesterday that it would be the standard rate and there are various arguments as to where it ought to be. Okay, thanks.

MS TAYLOR: Yes.

CHAIR: I think that brings to a conclusion the questions that we had. I would like to ask whether you have any further comments you would like to make or, Ken, if you would like to make any final comments at this point.

MR FORREST: No, I am happy, thank you.

MS TAYLOR: No, that's fine for us today, thank you.

CHAIR: That leaves it for me to thank the 21 companies and of course PricewaterhouseCoopers for your written submission and your oral presentation today.

You have had a tremendous impact on the regime as it has developed through the means of bringing the group together and forming a view and I just note the Commission has always found that approach very pragmatic and of extreme usefulness to us.

So, I think we're very pleased to note that you've offered to continue this involvement through the workshop

process and I think it will be of critical importance to the further development of the information disclosure regime.

So, having said that, again, thank you very much and please pass our regards on to the 21 lines companies.

We now will break for lunch and we will be reconvening at 1 o'clock promptly, at which time Vector Network will provide a summary of their submission, followed by questions from the Commission.

So, thank you all for the assistance in making this work today in what is a much smaller room at this end of the video conference. So, thanks again. We will see everyone at 1 o'clock.

Conference adjourned from 12.20 p.m. until 1.00 p.m.

PRESENTATION ON BEHALF OF VECTOR NETWORKS

CHAIR: I would like to recommence this afternoon's meeting.

We have on the agenda this afternoon both Vector Networks and Jardine Lloyd Thompson.

I do appreciate the effort that Vector has gone through to facilitate the video conferencing. We will have to work really hard to speak loud in order to make this work because we only have a limited number of microphones at this end.

So, if you can't hear what's being said, please let us know as soon as possible and we'll try to sort that out.

MR VAN BRINK: Will do.

CHAIR: If I can formally welcome Vector to the proceedings and ask that you introduce yourselves for the record. You can begin with your summary of your submission when you are ready, thank you.

MR VAN BRINK: Just before I start, you can hear me all right from this end?

CHAIR: Yes, we can, thank you.

MR VAN BRINK: Thank you for the chance to speak. My name is John van Brink. I am the acting General Manager Commercial at Vector. Before I introduce the team I would just like to extend appreciations for being able to present to this conference and for the ability to input into this quite important subject for us, and hopefully you'll find that our submissions, our presentation today, will add to the discussion and the information that you are seeking.

I think the importance we put on this process is reflected in the number of people we have here today. If I could start with the three of us here in Auckland, I have introduced myself. To my immediate left is Richard

Sharp, who is the Financial Controller of Vector; and to my far left is Duncan Head, the Transmission Evaluation Manager.

The Wellington side, I heard Peter's voice, I know Peter is there, our Regulatory Manager; Anton Murashev, Regulator Analyst; Joanna Perry, from KPMG; and Nathan Strong from CRA. Joanna and Nathan, while on our bench today, are available for approach by the Commission as industry experts and for any independent advice that the Commission may like to seek in the future. I just state that.

I will move into the presentation.

There is an overview slide there.

CHAIR: Can I just tell you before you start, I know often we ask questions as you present. We probably won't do that today, so we will just let you carry through your presentation and ask questions at the end. It is a little easier with the video conference.

MR VAN BRINK: That would be fine by us if you could.

In terms of the presentation overview, the next slide does show how we've categorised or subdivided the session today, to try and focus on key areas where we believe our submissions are of value.

After my short introduction, Peter Alsop will take over, followed by discussions by Anton and Duncan on areas of purpose of disclosure and subsequently the asset valuation issues.

Following that we'll be talking about common cost allocation issues; some areas of disaggregation and our views on that in terms of the information requirements that have been put in the discussion document; and finally the important area of financial reporting and interface of regulatory presented by Richard Sharp and Joanna at your end.

Anton will finish up and from there, as you mentioned, there will be time for discussion.

In terms of a summary of Vector's view to the discussion paper, we are concerned that the proposed disclosure regime may become too intrusive. Reading through the December discussion paper, we have no clear problem definition for disclosures presented. There's been expressions of a number of concerns that the Commission have raised. We are really unclear as to the extent or detail of some of those.

We feel, as a result of that, the approach to move to a greater level of detail in terms of a disclosure regime may well move towards a "nice to have" process rather than "must have" process; having information on tap just in case, rather than as required.

We feel that there is limited consideration by the Commission of what detailed disclosure would actually mean for the overall regime.

While we welcome the conference and the ability to present our views, it has become clear over the last day or so the number of details that have already come to light through the discussions, and we believe these need further debate and would certainly support any context of workshops to talk through some of these details at a later stage.

We believe that the Commission risks letting detail get in the way of Parliament's intent of a sound regulatory philosophy which doesn't go into too much prescription, and that the disclosure requirements specifically actually start to move the detail that would rather than supporting the threshold regime, may well complicate it to an extent where it becomes less effective.

More specifically, the approach threatens the

durability of the threshold and we feel the sole purpose of disclosure in Vector's view is to develop a time series of information and relevant data so as to set and reset thresholds.

On that note, I would move over to Peter to talk about the underpinning philosophy of the regime.

MR ALSOP: Thanks, John. As you mentioned, I'll talk to a section called philosophy underpinning the regime. I guess we started thinking about that philosophy out of concern of the proposed detail the information disclosure regime proposed by the Commission.

In terms of thinking about it, we went back to what we called the regulatory context. I will run through that slide.

Prior to the Commission, the regulatory regime for lines businesses at that time was largely based, if not entirely based, on disclosure.

The thresholds regime, with the passing of Part 4A, has now become the primary regulatory tool.

We witnessed that existing thresholds set by the Commission and therefore in our observation the Commission's view that their purpose statement compliant had been set on the basis of a subset of existing disclosure.

So, therefore, given the thresholds are the flagship of the Part 4A regime, in our view, any information outside of that needs very rigorous assessment.

We make the observation that the investigation and control phases are very much about forward looking information to ensure if controls are imposed that it's sufficient going forward. It is not about historical disclosures.

More generally in terms of the regime and its components taken together, using the thresholds the

Commission should be and is most interested in identifying performance trends and exploiting those trends by identifying industry leaders to move the pack of lines businesses in the right direction.

And through the establishment of the relative approach, at a principle level that is a very desirable mechanism because it creates incentives for lines businesses to perform better than each other, therefore moving the trends directionally the right way.

So, to identify trends, in our view, detailed information through disclosure is not actually required.

In fact, more substantively, careful implementation of the regime is required is detailed information, as we'll explain, could be counter-productive and will be counter-productive to the thresholds concept.

Just building on those thoughts, turning to the holistic view required. In our view for the Part 4A regime to remain current over time, the thresholds concept, which is the flagship component of the regime, must be durable.

Therefore, a holistic view as to how the different parts of the regime feedback into that is critical.

In our view, the Electricity Commission's work is also very relevant because there's aspects of the Electricity Commission's work stream that will help move trends and performance in the direction that the Commerce Commission is looking to achieve.

We equate extensive disclosure as that proposed and looks to be proposed on the agenda going forward. We equate that to our building block analysis either explicitly, the information is there, it seems the Commission may want to be able to do that; or implicitly, for stakeholders outside the process or Commission staff or whoever, if the information is there our concern is

that someone will use it.

The concern is that this will, in a de facto way, create new thresholds. This is very consistent with Vector's submission in the context of the information and inquiry guidelines that the Commission has adopted. Most other lines businesses took the approach that more detail was better so they knew what the detailed methodology would be for control.

Vector cautioned against that on the basis that the more detail you put in those phases the more people looked at them, therefore the more redundant the thresholds become and the regime starts to collapse; in our view in a slippery slope towards what has happened in other jurisdictions.

To complete that slide, that is not in our view what the Part 4A regime intended.

So, this leads on to what we've called "implementation style", which is something we think is in the Commission's own choice and the approach that it chooses to adopt to satisfy the purpose and implement the regime.

Because of the flagship nature of those thresholds, we believe the Commission needs to keep coming back to ask itself the question, what does this intervention, or what does this phase of the regime mean for the thresholds concept?

Part of that is increased cognisance or recognition of the benefits of the investigation and control stages, even as a threat if companies don't breach the thresholds, those stages promoting desirable behaviour.

We are currently in breach of thresholds. Even outside that we look at those stages as being high risk to the business. The Commission has adopted very wide ranging investigation guidelines. So, that high risk gets equated, in our minds, to very strong incentives for

positive performance.

In addition to the natural incentive properties of the regime that's inherent in the legislation, we consider the Commission should adopt what we call a more facilitative approach.

MS BATES: Where are you at?

MR ALSOP: Implementation style (1).

What we mean by this facilitative approach is the Commission working with lines businesses to resolve emerging problems, somewhat akin to a self regulatory environment.

That would entail the Commission, having robustly analysed and defined a problem, giving lines businesses an opportunity to address it particularly during a regulatory period.

Perhaps an example we'll touch on more later is the issue of any pricing differentials between non-contiguous networks which the Commission has made some public comments about, provided issues like that are robustly defined we think it is a good thing the Commission airs its thinking that this is an issue for the regime to address, and lines businesses like ourselves take great heed of those comments and seek to address performance accordingly.

This facilitative approach in our view will avoid the extensive prescription and intervention of the information disclosure regime is proposed to lead to.

Moving on to the next slide, "implementation style (2)". We accept that the more process oriented or principle outputs based approach that Vector is advocating may in the short-term elicit gains slightly slower than a more hands-on detailed specific approach.

However, we still think the Vector approach is compliant with the purpose statement. It will achieve the

lions share of benefits it is looking to achieve at considerably lower cost.

It gives the regime the strongest chance of long-term success. Critical to that is the durability of the threshold concept, the flagship aspect of New Zealand regime; and therefore far greater long-term benefits.

In our minds, this style we're talking about is all about short-term versus long-term trade-offs, that the Commission working with interested parties need to make, and in our view the long-term is far more important.

On the next slide, at a very conceptual level, we've tried to give a graphic of that approach that Vector is advocating and, sort of, in the short-term, sort of close to zero on the X axis, we note a pinnacle of prescription, in a more static efficiency type environment prescription and detail may lead to some good short-term gains through prescription. However, over time the benefits of that approach greatly eroding, being surpassed by the more principle based approach, which if left to run its course would generate far longer term benefits for the country and ensure the long-term success of the regime.

Other key themes arising out of this, is Vector acknowledges that detail on inputs does have a role in the regime but it is during the investigations and control phases.

But even then, great care must be taken.

In our view, the Commission needs to look carefully at breaches and magnitude of those breaches before it decides, as the Commission does, we would add, as to whether any further information is actually required.

In underscoring the fact that information on detail is only relevant at the investigation and control phases, it is possible some lines businesses will never breach the thresholds, thereby making disclosure of more detailed

information wasteful. Some may argue the ultimate success of the lines regime may be to achieve the lighter-handed purpose of Parliament, lines businesses actually complying with the screening mechanism of a threshold that the Commission has set.

We also in thinking about the detail and stepping back from that to think about philosophies, have thought of some other strategic issues that are of far more critical importance to the long-term effectiveness of the regime than the detail of disclosure.

For example, how will the threshold reset work? What is the sharing rule? Which is arguably, or it is a critical component of incentive based regulation which the Commission has yet to say anything about.

Should lines businesses beat their price path, should they not?

What is the resection methodology in 2009? We note, in our view, it is important to have the buy-in or at least the participation in the process from the Electricity Commission, given the prospect of the regime transfer.

I guess I float on the side we heard the question yesterday put to ENA as to whether the Commission could commit an organisation in the future to a particular methodology. In our view there's no legal basis to allow the Commission to do that. Nonetheless, the Electricity Commission, working in concert with the Commerce Commission and stakeholders, would send signals to stakeholders that the Electricity Commission having had its say and have a view, may be minded to adopt the same method if it took over.

The issue cuts to regulators when they have the opportunity or responsibility to implement something, actually taking cognisance of the recent processes that

have come before them. Any change to those exacerbates regulatory risk if the opportunity is taken to change rules that have been in existence as the law and companies have complied with them in good faith, that is what they're being tasked to do.

A further strategic issue is the general level, the risk of investigation and control to the thresholds concept as well.

So, the company is investigated and found that the breach was efficient, does it get a new company specific threshold? Does the administrative settlement amend the threshold that they've got? Do you control a company that has consistently breached a threshold?

Those sorts of high level strategic questions are far more significant than the detail of disclosure and should be the priority of the Commission and interested parties in the very near term.

Another key theme we summarise, having thought through the process, was a quote "for the perfect is the enemy of the good".

We have a concern that there's a view prescribing detail could result in the perfect price path or engineer, the perfect CPI minus X control and achieve better long-term benefits.

In our view, come back to an 80/20 philosophy which we feel is consistent with Parliament's intent, Parliament wanted to avoid the detail inputs based information and tentative approaches that have dominated the landscape overseas and come up with something sort of a bit Kiwiana that is well suited to New Zealand's context.

We have summarised that as an 80/20 philosophy.

That cuts to, in our view, emphasises the importance of incentives or processes and moving trends to get desirable outcomes over time.

That's our view of it. Coming back to the Commission, our observation is the Commission is placing considerable faith in the ability of prescription to beat a more outputs based approach and in a related way, achieve those outcomes more cost effectively than the sort of approach that we're proposing. It's not clear to us that the sort of cost benefit assessment between a more principled based approach and the prescription, the incremental benefits there, are positive or negative has been worked through, and in our view they're strongly negative.

A rethink on the role of disclosure generally is, in our view, required.

Moving on to the slide called "other key themes (3)". We note we do appreciate there's an option value to the Commission from having a wide range of information at its disposal.

As noted before, this is akin or analogous to what we see as the very wide scoping investigation and inquiry guidelines the Commission has adopted for the subsequent phases of the regime.

However, that sort of option value and flexibility needs to be balanced against the costs and risks that it entails.

I made the following sub-point that relates to being cognisant of historical requirements that exist, changing them when you have the opportunity to do so exacerbates the regulatory risks that companies face.

In closing in my section at this stage, rigorous assessment of the value associated with each regulatory intervention, including disclosure, is critical.

That importantly includes the whole of regime implications, to consider those feedback loops and incentives and where the regime may be heading or

descending into, and come back to the point on John's summary slide, the sole purpose of disclosure should be to develop. We already have a data set, so we have to keep that in mind, but develop or increment on what we have, to have a robust data set to set thresholds and reset them over time.

All other information requirements are distant to that purpose and information can be achieved in other ways, as Anton will come to, and in the subsequent phases of the regime.

I hand on to Anton to talk about the purpose of disclosure.

MR MURASHEV: Moving on to the next section I would like to talk about the statutory framework.

We think that the purpose is quite broad and could be achieved by a much more de minimus approach than proposed by the Commission at this stage.

The overall purpose of both sub-Part 1 and sub-Part 3 are identical, except for the actual tools that are being used to achieve it, and to achieve sufficient outcomes for relevant market. Sub-Part 1 does that through thresholds, investigations and threat of control, whereas sub-Part 3 uses information disclosure.

Because there are those different tools to the same end, we think the effectiveness of both of these tools should be assessed together holistically rather than looking at them separately.

In terms of looking at disclosure, I think it needs to be assessed on its incremental value and implications for other parts of the regime over time.

Moving on to the second slide. The Commission's interpretation is that the scope of the disclosure can be broader than information on line business, that's at least our reading of the Commission's paper.

We would like to note that in our view section 57T(2)(a) of the Act clearly limits the scope to information concerning ELB's business as a line owner or electricity distributor.

Therefore, we think any business activities outside that, whether regulated or not regulated, are clearly outside the scope of the regime under Part 4A generally and information disclosure in particular.

I would like to talk about the context of disclosure in overall regime. We think that the thresholds and threat of an investigation and control provide very strong incentives for lines businesses to comply with the overall purpose of the regime.

We think that the bulk of the benefits for the achievement of the purpose are supplied through that tool.

The compliance statements ensure there is extensive information available to the public, and that information is in both price and quality which are the two aspects we think are most important to consumers.

The Commission also has extensive information gathering powers which it can use at its discretion.

We think that when considering disclosure, the Commission should really look at the incremental benefit of having that information in the public domain, rather than just available to itself through its own information gathering powers.

MR ALSOP: John, just a note to the Aucklanders. I think we can pick up on your paper shuffling. It is slightly concerning us, thanks.

MR MURASHEV: The first slide of purpose and objectives. We note in the Commission's paper there is a statement to the effect that the Commission considers that disclosure should promote allocative, productive and dynamic efficiency.

That seemed like a bit of a stand-alone statement, and we think it is the thresholds that provides those incentives for those efficiencies to be gained, and the disclosure only provides those incentives by supporting the thresholds.

That is why we think all disclosures either current or new ones should be linked back to that purpose of supporting the thresholds and that information disclosure shouldn't be a regulatory discipline in itself.

I think that it's very important for there to be clarity around what information is needed by whom and why. And looking at the Commission's paper, sometimes it wasn't clear what information was needed for its own purposes, as opposed to what the Commission thought would be useful for the customers and other interested parties to have.

We haven't really seen any evidence of a needs assessment by the Commission on a state-by-state basis of the disclosures that are proposed.

We have suggested some guiding questions that we think the Commission should apply. We are not necessarily saying these are the absolute perfect questions to ask, but we think that something of this nature should be gone through and looked at.

These are firstly:

What problems exist? Was the evidence of those problems actually existing?

Is the problem, if there's one, durable in nature? Will they be addressed over time by some other means, for example, through the natural effect of the thresholds?

If the information is required for a specific purpose, is public and regular disclosure necessary, or is it more appropriate for the Commission to have that information through other means, like its information gathering powers?

Finally, is there a net benefit from moving away from the status quo, to be that no disclosure or under current requirements. So, will the additional costs of creating a new requirement or changing a current one and the costs associated with moving to that, will that be worth the benefits?

Once again, we would like to say it's important that each disclosure, not only the proposed new disclosures but also the current ones, are evaluated using these sorts of questions, because we think that this process is a new start for the disclosure and it could well be that there's many things in there that are not needed.

The criteria set out in the Commission's paper are well-intentioned but they are quite vague and would be hard to apply in practice.

On this I would like to hand over to John to talk about the proposed disaggregation of information.

MR VAN BRINK: Thanks, Anton. Moving on to the first slide, entitled "proposed disaggregation of information".

Disclosures and the thresholds should be consistent and we believe the thresholds have correctly focused on an average, rather than individual price, prices and quality. On the basis that it really aligns with the Commission's previous comments that have been made in the past, that focusing on average prices encourages allocative efficiency.

We have a quote from the 2002 paper from the Commission. In terms of this aggregation, our question really is, what has changed? Is there some evidence that there are issues there? And who is concerned?

Vector is certainly keen to understand what has caused the Commission to ask for views on levels of disaggregation so that we can discuss those further.

Moving on to the next slide on proposed

disaggregation.

Information is also disaggregated in several areas. A good example is pricing is disclosed by pricing region, it's disclosed regionally and also by customer segment.

In Vector's case, disaggregation of price and service entails a published definition of service areas and commits service levels by areas and customer grouping, so there is an aggregation there.

The difference from Vector's point of view is that we use publishing commitments, in terms of service, so a customer can see price, follow the issues clearly, and we believe it is far more important than providing historic information.

Vector is accountable to stakeholders, our customers, and we believe that in terms of the way the threshold regime is working, requiring consumer engagement and linking price and quality, it is leading to a good outcome over time.

It does take a little bit of time to put these links into a more clearer effect for consumers to understand.

Vector is concerned about the cost of disaggregation of data and the likely confusion of details with some 1,200 feeders that we have under our control, covering areas we believe to be rural through to the CBD, which was a mix of customers from industrial to commercial to residential. There are some real costs and also issues of being able to identify what the detail really means when it is disclosed.

Moving on to our next slide of disaggregation, Vector is not sure where the proposal is leading. Whether we're talking here about area or regional thresholds or customer based thresholds, because there is quite intricate and complex, especially in areas like Auckland and Wellington, between customer and regional attributes and network

definitions are quite different throughout the country.

We believe as long as a lines business complies with existing thresholds, then the regulatory intrusion should be limited based on an average disclosure process.

That's on the basis that disaggregated analysis is always possible through the post-breach investigation process.

I really feel that such a process can be much more targeted and identify issues rather than perhaps looking at symptoms where situations warrant further investigation.

We believe that considerable disaggregated information is already available and also, as we will allude to a little later on, the work being undertaken by the Electricity Commission to develop standardised processes into things like pricing approaches and methodology, retailer contracts and use of network agreements, that standardising approaches which make comparison benchmarking much more easily in the future.

On that note I move on to the area of discussing the interface of regulatory and financial reporting and hand over to Richard and Joanne.

MR SHARP: Moving on to projection. The Commission's discussion paper proposes the disclosure of projection.

There is, however, no clear purpose on why these projections are required, who will be using them and what they will be used for.

The question needs to be asked as to what will be the incremental benefit of requiring the disclosure of these projections, as opposed to the Commission obtaining the same information using its information gathering powers?

If this information was also provided to the Commission in confidence, this would also tackle the issue of commercial sensitivity.

Projection has no use for thresholds.

Projections are also not required for statutory reporting but, however, publicly listed entities may be required to update or add to these projections once they are disclosed under NZX Listing Rules.

Vector makes reference to the other regimes in the paper that use projections is also worrying to Vector as these regimes are heavy-handed and differ in significance from the New Zealand context.

Just moving now to the next slide, reconciliation. The paper also proposes public disclosure of reconciliations between regulatory and statutory accounts. Vector disagrees with this proposal.

Regulatory and statutory accounts have different purpose and different scope; statutory accounts are prepared through a business or group of companies, whereas regulatory accounts are only prepared for a business segment.

The only feasible purpose of regulation is to ensure - sorry, of reconciliation is to ensure the correctness of the regulatory accounts, but this is already achieved through the auditing process. Therefore, there is no incremental value of disclosing reconciliations.

The second slide on reconciliation. Vector does agree that the Commission may need information on contestable services directly related to the electricity distribution.

However, this is already addressed through the thresholds regime where reasons for excluding services are disclosed and further information can be requested and provided if needed.

Making information on contestable services publicly available can also unfairly advantage competitors in areas

where competition is workable and effective.

If required, information on such services can be provided to the Commission in confidence and we would see that that information is then not publicly available until it's been decided that these services are not contestable.

I now pass over to Joanna in Wellington to cover off the regulatory accounts versus GAAP issue.

MS PERRY: Thanks, Richard. Just the next two slides, perhaps if I could just consider them together, and I would also like to preface my comments by saying that, as described earlier, I am a partner at KPMG. I am also the -

MR VAN BRINK: I just pass over to Joanna. We've got no sound at this end.

MS PERRY: Can you hear now?

MR VAN BRINK: Yes, thank you.

CHAIR: I had turned it off because of the echo. When we are speaking here you should turn your mute on so we don't get the echo in the room.

MS PERRY: Can you turn your mute on, Richard?

MR SHARP: Yes, we are doing it now.

MS PERRY: I will start that again. Perhaps if we just consider the next two slides together and I would preface my comments by saying that, yes, I am a partner at KPMG but I am also the Chairman of the Financial Reporting Standards Board here in New Zealand. That is the board that is responsible for preparing financial reporting standards and essentially New Zealand GAAP, and I am also a Securities Commission member.

So, my comments are really on the basis of my experience as a standards setter in considering GAAP and also in relation to 15 plus years as an audit partner, auditing both financial statements that are prepared in accordance with GAAP and financial statements that are prepared in accordance with other rules, as it were, and

considering the Securities Regs that were regs that were effectively drafted some 20 years ago and are still there trying to be applied as regulation.

So, in essence, I guess the consideration that I put in relation to the issue facing the Commission as to whether there should be separate rules for the regulatory accounts or whether they should be GAAP accounts, are things like the status of GAAP, the fact that GAAP is globally acceptable. How GAAP has developed, I think, is quite an important thing to consider, the due process that is gone through in developing GAAP.

The next thing I considered was that the qualitative characteristics of GAAP, and are these, in fact, substantially different from the implementation principles actually proposed by the Commission?

The question of, in fact, a disclosure regime, is it actually based on GAAP accounts reflecting perhaps then account KPIs for that industry, such as used for banking regulations here in New Zealand.

And then, of course, the difficulties encountered when the regulatory regime is different and GAAP evolves and the regulatory regime doesn't.

For example, as I said before, what's happened in relation to the Securities Regulations.

And, of course, in relation to all of that, any additional compliance costs of any departure from GAAP.

I have to say in considering those things that my overall conclusion would be that I would certainly encourage the Commission to move as little away from GAAP as possible in terms of coming up with any additional prescription.

I think GAAP financial statements can satisfy the requirements of a regulator. The qualitative characteristics of relevance, reliability,

understandability and comparability, to me are exactly what is sought in relation - as the basis of information for a disclosure regime of regulation.

GAAP financial statements are widely accepted and understood by both users and preparers, and in fact the move by New Zealand to move to international financial reporting standards, I think, will make that even more so, in that they will be comparable. One of the key things globally, not necessarily something that a regulator needs to think about, but something I believe that needs to be taken into consideration.

I think also the due process. The due process that is undertaken, as I can attest to, is onerous both here in New Zealand and globally when we move to the other standards. To ensure that as GAAP evolves, as it always does, that, in fact, it is supported by those users and preparers and regulators and everyone in terms of submitting through those.

I guess I would question whether the Commission has the resources or the inclination to actually go through a similar form of due process in relation to prescription for regulatory accounts.

I think the other thing is, although initially we may say, okay, we'll come up with a way of doing this and the differences between GAAP and the regulation aren't that large, as things evolve it may get more and more.

As I say, my experience with the Securities Regs is something that was 20 years ago is, and you look at them now, it is actually really, really hard to say, "Well, those are there and that's what we have to comply with," and yet GAAP is moving and is way over here.

So, I think that that is something very much to think about.

Obviously, the business being regulated, the scope is

different, but to me that doesn't mean you move away from GAAP. It can be - it is the segment. You are disaggregating the information but you're still using the recognition and measurement criteria in relation to GAAP.

I could say a lot more and I am certainly happy to take questions moving forward, but certainly my experience as a standards setter and as an auditor is to really encourage you not to move too far away from GAAP. Thank you.

MR ALSOP: We are going to move on to Duncan Head in Auckland to talk through asset valuation.

MR HEAD: Can you hear me okay?

MR ALSOP: We can, yes.

MR HEAD: Just starting on the first slide entitled "general view". The main issue regarding the provision of electrical distribution services for consumers is a price paid versus the quality or the service levels that they receive.

In essence, consumers are asking whether they receive value for money.

The consumers are interested in the valuation or regulatory profit measures of their lines provider, compared with the price and quality proposition that that should have been offered to them.

Under the threshold, the valuation is an important part of the regulatory process. This means that the lines businesses need to be acutely aware of the regulatory effects of the valuation methodology and try to balance that against providing the service levels demanded by customers at a price which is not only acceptable to the consumer, but which also provides an adequate rate of return to the investors who are investing in long life sunk assets.

In terms of the regulatory valuation, Vector

continues to promote a principle of price based approach. We believe it will ensure the valuations are fair and accurate over time but they result in lower compliance costs -

CHAIR: You just need to speak a little bit slower for the transcriber.

MR HEAD: Sorry about that.

I will start back on - I am referring here to the second bullet point on the slide. In terms of the regulatory valuation, Vector continues to promote a principle based approach. We believe it will ensure the valuations are fair and accurate over time and they result in lower compliance costs and are flexible enough to changing circumstances.

From what we've seen, the flexibility is probably one of the main issues with which the valuation methodology will need to take hold of.

We also note ideally the regulatory valuation should be consistent with relevant accounting principles and standards as possible and that goes towards what Joanna has been saying.

MR ALSOP: Duncan, I might just -

MR HEAD: Moving on to valuation choice.

MR ALSOP: I might just make a quick comment. Duncan made a comment that in Vector's view asset valuation was an important part of the regulatory regime. That could have been interpreted as an important part of the thresholds. It's not actually our view that the C2 factor is necessary for the regime at the Commission's operationalising, however we do recognise valuation is playing a role in the regulatory regime and therefore Duncan's comments should be seen in that light.

MR HEAD: Valuation choice. We note the promotion of valuation choice to address the valuation issues raised by the

participants in previous consultations is appreciated.

However, the proposal in the Commission's valuation choice consultation paper, it appeared to be significantly different to what was contemplated when the historical IHC method was first mooted. The current proposal appears to move away from the issues that were originally trying to be addressed regarding valuation and the regulatory regime and has instead provided what some consider to be a Clayton's choice between the methods, and that is particularly IHC versus ODV.

Moving to the next slide, "valuation choice (2)". We believe that the choice between ODV and IHC as described in the documentation is superficial in nature and having had the opportunity to review other parties' submissions, we confirm our view there are only downsides to the current proposal.

Given the intent is for ODV and IHC to provide the same result over the long-term, Vector believes this will not be achieved under the current proposal, or if it can be, this will be at the considerable expense and will ultimately fall on the consumer.

Of other significance and concern is any divergences that are not fully addressed between the two methodologies will cause concern over fairness when the thresholds are reset.

Moving to the next slide, "outstanding ODV issues". The issue of developing and documenting a process for the regular updating of the valuation handbook has still not been addressed.

This not only applies to the updating of the standard costs, but also to such items as multipliers, multi-equivalent asset definition, the inclusion or exclusion of assets in the valuation handbook, and the length of time allowed for the allowable planning horizon.

If you can move two slides ahead, Anton, to the quote entitled "rising cost of road works".

The quotes listed here are from the CEO of Roading New Zealand and the Contractors Federation and they are indicative of the current price pressures being placed on infrastructure companies in New Zealand.

Vector is in a similar position to what's happening in what these quotes refer to in that we're seeing significant price pressures for competitively tendered projects.

These primarily are brought about by specialised skilled labour shortages and increasing pressure for raw materials from global infrastructure investment and is putting significant costs, as we've seen, occurring month on month in projects that we are putting out to market.

If we can move back two slides to the outstanding ODV issues. As previously submitted to the Commission, Vector contends that a number of the issues caused by a prescriptive valuation methodology could be resolved by allowing efficient actual costs to be used in valuation process.

This will not only ensure a more accurate valuation over time but will also reduce any diverse incentives for investment if the valuation does not reflect actual conditions that the companies are experiencing.

If we move to the next slide, updates and indexing. The first bullet point there restates my previous comments on the ability of standard costs and multipliers to become quickly outdated.

Moving on there, Vector agrees that if the valuation methodology does not allow efficient actual costs to be used, which inherently factor in the positive and negative movements in prices, then some form of cost adjustment or indexing needs to be applied in the intervening years

between the valuations.

This will ensure that the companies facing different operating environments do not receive perverse investment signals and that the "revaluation" is managed.

If we move to the slide "updates and indexing (2)". In review, we've taken a look at what the available aggregate measures available are and some of the ones that are being proposed in other submissions from parties, and we've come to the conclusion that the aggregate measures are not well suited and there needs to be - the ultimate trade-off will be the trade-off between establishing an industry specific measure for the electrical industry with some form of periodic updating of the handbook, costs and multipliers.

Lines businesses could then use these updated costs without having to go through a full valuation process and Vector is comfortable with that valuation, the full valuation under the ODV sitting at once every five years.

Move on to the slide entitled "expenditure reviews". Efficient investment is the goal of line businesses, their shareholders and the Commission.

Lines businesses and their shareholders and stakeholders, whether they be private investors or through consumer trusts, are always looking to have the most efficient investment there for the stakeholders and consumers.

Vector does not support IHC, but if implemented we would agree that some form of expenditure review is required.

We have noted that Aurora's suggestion of review on large capital projects is probably a pragmatic solution to us.

Vector, however, does not support expenditure reviews for ODV valuations in the intervening years between the

full valuations.

We believe that the audited reviews conducted during the full ODV valuation process is sufficient.

We move to the slide optimisation approach for Transpower. In Transpower's submission they have put forward the contention that optimisation should not apply to the investments approved by the EC under the grid investment test.

We note that the Electricity Commission's grid investment test is, however, very similar to the engineering and economic assessments that are carried out in the normal course of business for most organisations.

What happens is we look at what the investment entails, look at whether it's economic, or look at whether if it's necessary for system security.

There doesn't seem to be anything special about the Electricity Commission's test under the grid investment test that would seem to warrant pulling out Transpower to be a special case.

If we move to the next slide. Optimisation provides and strengthens the incentives to, in Transpower's case, ensure that all necessary work on the investment proposals is done.

It also ensures the Electricity Commission properly evaluates Transpower's proposals. And we know here that even the regulators, given their incentives, can gold plate.

The measure of success of the Electricity Commission's decision-making under the grid investment test ex-post will be important, as it ensures that Transpower will maintain commercial rigour on its investment decisions beyond the investment date.

If Transpower's decision under the grid investment test are pulled out of this optimisation process, then

there is no forward looking pressure on Transpower to manage the commercial rigour which other lines businesses face.

We also note there in the last bullet point that there needs to be consistent treatment of all lines businesses and Transpower is just another lines business. It should manage its optimisation risk in the same manner that other lines businesses do and it should be reflected in its WACC, not as an untouchable asset base.

Move to the next slide under "mergers and acquisitions".

It's Vector's contention that the valuation updating process, if it's accurate, there will be no need for the new network owner to prepare a full valuation for its overall business if it acquires another network company or another group of assets.

Where the Commission considers it requires such a valuation, it could request this under its information gathering powers; otherwise the normal valuation cycle, which is proposed to be one in five years, would apply.

We would note that if there is an indexing methodology applied, and in the intervening years when a company is acquired or there's a merger, if there is a request to prepare a full valuation in the intervening years, then this may imply that the indexing methodology is somewhat flawed and we would suggest that the numbers produced are not correct.

We would also note that if the choice between ODV and IHC is retained, there appears to be no concerns with businesses switching methodologies, given their intended comparability and the fact that the answer, in effect, should be the same under both.

Moving to the final slide, entitled "non-system fixed assets".

We would note here that for regulatory valuations to be robust and most importantly accurate, non-system fixed assets and intangible assets must be included.

Below is a quote there from the Commission's discussion and inclusion of non-system fixed assets and working capital in the regulatory asset base.

We note the valuation of these assets, the non-system fixed assets, should be carried out in accordance with generally accepted accounting principles and in particular FRS 3.

We note the adoption of international financial reporting standards in the near future would provide improved guidance on this issue.

The regulatory treatment of these assets, therefore, should be consistent with the new standards when they are adopted.

I would now like to pass on to my colleagues for the common cost allocation portion of the presentation.

MR ALSOP: Just before I move on to common cost, Nathan would like to make a comment on valuation.

MR STRONG: Sure. I mean, I think the issue of valuation choice between IHC and ODV can actually be - I mean, we can tell something about that already through the ODV disclosures between 2003 and 2004. The information that you released yesterday on the lines businesses show that the average change in ODV had been 28%.

So, the average would represent a capital goods price index for the entire sector, if you measured it from 94 through to 2004.

And so, that would give you a capital goods price index.

Then if you look at the range of results around that, you have some lines businesses reporting a 10% increase in their ODVs, so obviously the mix of assets that they had

was quite different from the average, others had a 54% increase.

So, I mean, just to look at that notion of, would indexed historic cost be the same as ODV? Well, the answer that we already have is that it would be quite different.

When you start to consider that there would be a difference in indexing, as well as potentially a difference in the rigour, shall we say, between different prudence or efficiency for optimisation type reviews, you start to wonder, "How should that impact on any price path?"

From that point of view, if you're looking at C2 factor considerations, if you are to continue with that, then there has to be a difference in the basis for comparison there.

So, I just would like to draw that to your attention, that although the paper does talk very much about IHC and ODV being the desire for them to be similar, they are in fact different and that must have implications for how you think about setting a price path and comparing businesses.

So, that's the point I would make there.

MR ALSOP: Moving on to the issue of common cost allocation.

Vector's view, the importance of this issue to promoting economic efficiency, including through capital market transactions, cannot be underestimated. It's hugely important.

At a principle level, spreading costs across multiple business activities is unequivocally desirable behaviour and needs to be incentivised.

We observe that the number of distribution businesses in New Zealand probably bears this out and most people I think hold that view.

In our view, the Commission should be more concerned

that efficiency gains actually occur in the first place; not who actually gets - not exactly who gets what exact cut.

So, the Commission's work in this area, even at a discussion level or disclosure level, will actually be a key determinant of whether such gains are made in the first instance.

As we read the papers, we witnessed that the Commission's concern, in our view, is two-fold, that lines consumers may subsidise lines businesses operations from the businesses - sorry, I lost my train of thought. The concern was there may be excess of costs loaded into the electricity cost base; or costs, even if they were efficient for an ELB stand-alone basis, those costs not being fairly spread through other business activities.

I can address those two issues in a couple of slides as individual issues.

In considering common cost allocation, the context is important and the importance of the counterfactual.

That counterfactual is, if a lines business is a stand-alone lines business and only doing that business activity, the Commission's regime allows and accepts that business to have an efficient cost base on the stand-alone electricity basis. As for all businesses, the price path ensures gains in that regulated business are shared over time.

This is important to bear that counterfactual in mind because it is very possible that some lines businesses do never engage in other business activities, or equally that some lines businesses engage in other activities now, may exit them if those are profitable or successful activities, or even if its regime through consideration of cost allocation actually incentivised lines businesses exiting such activity.

We also note that even if hypothetically electricity lines costs are spread elsewhere, lines consumers are no worse off than the counterfactual, stand-alone counterfactual, and the country is unequivocally better off.

In our view, we thought that wasn't a bad issue for a regulator to have on its hands.

MR STRONG: If I could interrupt. I think that - there's possibly a terminology issue here. I mean, the issue really comes to a business making an incremental decision about whether to enter into or exit another market.

So, what the ACAM approach is achieving, is sort of leaving that incremental decision undisturbed by whether or not you have a lines business.

So, the use of the term "spreading costs" is perhaps not quite right. It is more that ACAM is leaving business decisions being undisturbed by having to think about the fact that you are actually - you own a lines business.

One of the - there are some interesting comments on this made yesterday. The Genesis folk were talking a bit about if lines businesses start to get into telecommunications network, and I think Commissioner Taylor picked up on this as well, thinking about how would you think about revenue and cost allocations when that happens, I think it's quite a neat example. Because when you think about a lines business getting into telecommunications, you know, we know it's a really competitive market, there's probably quite a high cost of capital associated with that.

So, you know, you would want a business decision made on an incremental basis. You know, "What are the incremental revenues we might get out of this? What are the incremental costs of getting into the business? What are the risks?" Telecom would obviously have a fairly

strong incumbent response, as with the other telecommunications providers.

And so, you know, from a consumer perspective, you would think that, "Well, I'd be very happy for lines businesses to get into this activity."

But when you start to involve in that decision a non-ACAM based cost allocation method, if you're getting into a telecommunications business and have to worry about the fact that, "Well, I'm now going to have to allocate and recover through those customers costs from another business," then that incremental decision that is disturbed, and so potentially you won't enter the market, or you might delay entry.

And so, it's that sort of dynamic long-term decision that is relevant to thinking about cost allocation methods.

Hopefully that will have even pre-empted a question.

MR ALSOP: Back to the slides, "context and importance of counterfactual", the bottom of that.

Vector agrees the allocation of costs to the regulated business needs to be transparent. And as has been noted in the Commission's paper and submissions, economic theory provides guidance on the efficient level to the extent it lies somewhere between the incremental costs and the stand-alone costs.

In Vector's view, ACAM is widely recognised as an economically robust methodology. In our view, the most robust methodology.

Consistently applied, it can provide for robust comparability between businesses.

If the Commission has in mind that alternative methodology, then it should consult on that view.

Or if the Commission is minded to keep ACAM and thinks it notes further prescription, it could further

prescribe it, but that's not supported by Vector; it could require the application of ACAM to be audited; and/or the Commission could itself audit the acquisition application of ACAM.

So, that hands-on experience, to the extent the Commission took it, would allow it to assess whether there is actually a practical problem with cost allocation as distinct from this being a theoretical issue.

More generally, however, the Commission can, and I am sure likely will at some point, examine costs allocation in the context of a control investigation, or in a different context where the Commission is empowered to regulate other activities.

The Commerce Commission did just that in the gas pipelines inquiry.

So we ask, why is the Commission specifically addressing this issue with disclosure?

We go back to the purpose of disclosure, to the extent it's needed. Disclosure is just that, it is a report mechanism, information transparency. It does not necessarily follow that there is a problem or any double counting in practice.

Going back to the two issues I start with, the first one is the efficiency of the ELB cost base. We suspect this isn't the Commission's main concern, the large portion of the cost base disciplined in its efficiency by the ODV handbook.

The price path thresholds builds on the already existent, natural incentive to cost minimise.

And as noted previous, the Commission can investigate the efficiency of the cost base during the investigation and control phases.

We suspect that's not the main issue. We just want to address it because we feel in some of the cost

allocation discussion it's got blurred with the second issue, so we wanted to separate those out for clear issue identification.

The second issue is whether costs are properly spread through business activities.

If the lines businesses is the core business, as it is in most or all cases, then if other businesses are regulated, or potentially regulated, the Commission, or indeed another regulator, can form a view on cost allocation, again as the Commission did in the gas inquiry.

If the other businesses are not regulated, then in our view the Commission still needs to establish that a practical problem, or problem in practice, exists.

As we understand it, the Commission has a concern that lines businesses cost-spreading can adversely impact on competition in other markets.

We have got some questions there. Which markets? What complaints? How durable is any competitive advantage?

Why are lines business synergies more important in those other markets than synergies that other competitors will invariably bring to the marketplace?

Are, in fact, competitors allocating their costs correctly to earn normal returns over their business activities?

If a lines business synergy is so critical in those other markets, could those competitors seek to partner with other lines businesses or other utility infrastructure players in the same area?

MR STRONG: If I could add to that. I thought it was a rather unusual definition or query in the discussion paper from a sort of competition law perspective, since, I mean, we're fundamentally talking about an efficiency gain here.

If the Commission is concerned that a business making an efficiency gain can lead to an anti-competitive outcome, that would seem to, you know, change the nature of how we think about competition law.

So, I mean, I just throw that into the mix. It struck me as being a rather unusual definition of when you might see an anti-competitive advantage being gained.

MR ALSOP: Just moving on to the slide issue 2 continued.

Consideration of this issue at a conceptual level, in our view, extends the ambit of regulation into competitive businesses.

While this is achieved by forcing electricity costs lower, given it is the business the Commission can regulate, it is tantamount to regulating other businesses, in the sense that the Commission will invariably need to take a view on the reasonableness of the costs in the other businesses, without really knowing whether those competitive businesses will be profitable or successful over time.

I have made a note to make a point about the incremental decision-making rule or concept that Nathan made previous, so I won't make that.

By the Commission's own logic, the Commission should be equally concerned with whether efficiency gains, including industry rationalisation, have been missed.

For the Commission sort of pondering the question, how should synergy gains be shared? That is conceptually the same question as asking, how could synergy gains be shared?

Continued emphasis on this issue, including through disclosure, unequivocally sets a disincentive for lines businesses to contemplate the sorts of innovations that we think are good for the country.

I thought it would be useful to put to the Commission

on the next slide what we see are the constraints on cost allocation, a balanced stakeholder view to running an efficient business over the long-term requires sharing of synergy gains with consumers.

Threat of investigation and control. Unequivocally, the threat of investigation and control has an impact. The Commission raising and consulting on this issue and thinking about it, it sends a very clear signal to companies that it is an issue of significance for the Commission.

Given the incentive structure in the regime, that will invariably feedback into behaviours that are desirable.

We do note that is consistent with what Vector is proposing in its so-called consultative approach, however that should be tempered and not taken too far.

The Commission wants to raise an issue or express a concern, it should do so very carefully on the basis of rigorous problem definition and analysis. If the Commission was to raise issues too often or on a basis that wasn't perceived as incredibly analysed or robust, that would be tantamount to regulatory requirements by another means.

We note in terms of the broader constraints on cost allocation, that EIRA exists and bluntly addresses cost allocation of lines business, this is a very draconian way. It has a more general concern about lines businesses getting into other activities, EIRA could have addressed that or still could.

If the Commission has ongoing concerns and thinks there are other business activities that should be regulated or relevant to the Part 4A regime, then they should be tested through Parliament.

The other constraint is merits aside, is the risk of

those other competitors in those other business activities making complaints if any conduct is seen as so unfair.

In terms of summarising our view on cost allocation, the Commission's focus should unequivocally be, what is an efficient cost base for running a lines business and only that business?

In our view, any gains made through operating outside - businesses outside the lines businesses are outside the scope of the Part 4A regime.

As noted, any gains unequivocally good for New Zealand and lines consumers are no worse off to the counterfactual where lines businesses just run their lines business.

It is not clear any actual problems exist. For example, in the setting of the C2 factor, or more generally in the setting of the thresholds a year or so back, there weren't any concerns expressed to our knowledge that cost allocation was unfairly advantaging or disadvantaging some companies over others.

In terms of those other markets, for some of the reasons I noted earlier, any competitive advantage in those, to the extent it does exist at all, it is unlikely to be sustainable.

We put up the red flag on this issue, in the sense that ongoing attention in our view will invariably result in lines businesses being incentivised. Whether they do it or not is another matter, but being incentivised to manipulate costs to look good. That could include missing cost sharing opportunities.

It also has a self-fulfilling prophecy of information on cost allocation leading to more information and more information over time.

And, in our view, the thin edge of the regulatory creep wedge, in the sense that the Commission would need

to take a view on the reasonableness of the cost base and other non-regulated businesses which then de facto get caught in the regulatory net.

We finish up with a "yes" there as to whether that was what Parliament had in mind. Vector's view is "unequivocally not".

MR STRONG: Just before you move on. I think this issue really cuts to sort of where the regime gets to in the end. You know, cost allocation is a really nitty-gritty issue and I think it was Alfred Kahn said in probably a similar setting, but the search for the perfect cost allocation methodology is like looking for a black cat in a dark room, except there's no cat.

You know, it's really quite a vexed issue.

If you look at, you know, how regulation as a concept has evolved over time, I mean, it started from rate of return regulation, which has really involved a lot of information disclosure, a lot of the intent scrutiny of individual costs and intent scrutiny of cost allocation.

The step into incentive based regulation was an attempt to get away from all of that, to say, "Well, let's try to get away from looking at the costs of the business and just, you know, is there some external benchmark that we can use that pushes in the right direction, creates the right incentives just for businesses to do the right thing, rather than have the regulator tell the business what the right thing is?"

So, I think, you know, the more that we bed down into, you know, cost allocation issues and the movement away from avoidable cost allocation techniques initially involves some sort of arbitrary allocation.

So, you start getting into that realm of, you know, arbitrary decisions being made, greater and greater scrutiny, and, you know, stepping away from the real

benefits of what we probably can get out of a thresholds type regime, which is more hands-off, and let's just push things in the right direction because you look at the regimes overseas and despite all that intensive information disclosure and scrutiny and negotiation between the regulator and the regulated companies, the results - things still go wrong.

You look at what's happened to New South Wales where the regulator at its most recent reset has had to lift prices because everyone, including the utilities, chronically underestimated capital expenditure over the last five years.

So, I mean, bedding down into the detail is not always necessarily going to be productive in terms of long-term consumer outcomes.

MR ALSOP: Anton is going to finish off our presentation with a section called "other disclosure issues".

MR MURASHEV: This is really a catch-all session for the sort of more detailed issues raised in the Commission's paper that we thought we would address in here.

The first slide deals with performance measures.

First we'd like to say that if a measure of returns were required, then an ROI-type measure would be best suited for this. I think the Commission should consult on the detail of how that measure is calculated before applying it.

With regard to quality performance measures, we question the benefit of additional requirements to disclose things like frequency, voltage, interference characteristics and consumer services information.

The information on frequency in voltage and interference is something that your average residential consumer doesn't really care much about.

When it comes to large consumers to whom it makes a

difference, they have direct relationship in most cases through a key account manager in the case of Vector, and that sort of information is readily available to them when considering things like upgrades or changes to the way their supply is fed up, we can run the models on them. So, those trade-offs and that type of detail is discussed with the consumers that are interested in it. But your average consumer just wouldn't find any use out of it, in our view.

Information on consumer services, Vector disclosed compliance statements under the consumer engagement criterion.

Also haven't had a look at other companies' management plans, but Vector has a section in its asset management plan to deal with customer satisfaction and services.

We disclose standard service levels to ensure customers are aware of the level of service they can expect.

The next slide shows an example of those service levels.

Skip over two slides to the certification and statutory declarations. The Commission should keep an open mind as to whether these are actually required.

It's not clear to Vector what the incremental benefit of certifications being signed by two directors, as opposed to the company's CEO would be.

We notice that in Part 4 inquiries, section 70E notices are usually addressed to the CEO, and if that were sufficient in that process, then why not under disclosure? We think certainly from our side of things it makes the process easier logistically to manage, not having to have a board meeting but having the CEO review and sign this off. We don't see any downside to information integrity

to having the CEO sign that out as opposed to the directors.

Publication channels and mechanisms. We think that the most appropriate method of publication is the internet. This is keeping in mind that consumers can expect information at the lines companies offices or have it sent out to them.

In terms of publishing it, we don't see an ongoing requirement for it to be published in the Gazette, given that that information can be obtained in hard copy through other ways.

If that requirement to publish in the Gazette is required, we would like to note lines businesses have no control over how long it takes from the point of the documents arriving at the Gazette office to the point where it's published, depending on how busy the Gazette is at that point in time, and the Commission had itself, very much appreciated, provided an extension for lines companies with the previous disclosures recognising the Gazettes simply couldn't get the publications done in time.

We think if you do retain that requirement, the timeframe should refer to a date when the disclosure should be up on the business's website and on the date that they are sent to the office of the Gazette, not the publication date in the Gazette, because we simply have no control over that.

I would like to talk a bit about the summary analysis if the Commission is required to undertake and publish.

I think that the purpose for preparing the analysis is quite broad. It talks about analysing the relative performance and performance over time of lines businesses.

It does not talk about efficiency.

We think the Commission should consider the

incremental value of having a very detailed analysis, such as that proposed in the paper, because we think that it could well be satisfied in, and the purpose of this analysis is to show something the consumers care about, so just price and quality, not the relevant efficiencies of the businesses because that is actually addressed by the thresholds and will fall out of that.

I think it's important that the Commission remember that anything it analyses and publishes will have an impact on the durability and the thresholds.

If the Commission has a separate detailed analysis that is carried out and then published in the summary in the public domain, that shows relevant efficiencies in businesses that are different to what was coming out of the thresholds, then it's risking companies being incentivised to try and look good under that summary analysis that is publicised, as opposed to will have an effect of a trade-off, looking good under that analysis and complying with the thresholds.

That's why we don't support the detailed analysis that is proposed and we would like to note that it's probably best that the Commission consult with consumers on what sort of analysis they're actually after. Do they want really detailed nitty-gritty stuff or do they just want a general focus on price and quality and what sort of detail they require? After all, the purpose of this is for consumers to be able to see the performance.

Moving on to the slide for compliance information. We agree that there is strong merit in continuing the requirements to publicly disclose that information.

However, we think the compliance statements should for a time be confidential until the Commission decides whether a breach has occurred and the nature of that breach, whether it is an intentional or technical breach.

There are real costs of being in limbo over a technical breach. Vector has experienced that first-hand over the last 10 months.

We are fairly regularly asked to update people, like banks and people who provide us with credit, what is going on with our breach? What sort of implications it may have for our business? What is the likelihood of the Commission looking further into this? What is the likelihood of control?

Those questions impact on our ability to secure finance and things like that. So, they are real cost.

That's why we think that technical breaches should be separately flagged as being outside the control of lines businesses and the investigation of such explicitly defined as off limits.

CHAIR: What does that mean?

MR MURASHEV: If the Commission has reached a view that its breach is technical, we would like the Commission to say any breaches of that type will not be investigated further.

MR ALSOP: Vector is in breach for 786,000 on a price path threshold related to the well documented technical reason of movements between budgets and transmission charges, nothing related under Vector's control or performance. In our view, the Commission, particularly under its wide scope investigation guidelines, could commence, if it so chose, a fully fledged investigation into all ambits of Vector's business activity.

Given that that breach, and potentially others over time, to the extent they're completely outside the control of lines businesses, that what we mean by being off limits to a more detailed investigation. There should be a separate category for those that are found to be completely outside control of the lines companies

concerned.

MR MURASHEV: So, it is an undertaking, if you like, from the Commission in its guidelines, for example, to say, "If we find a breach that is obviously technical and unintentional in nature, we will not go further in our investigations."

Moving on to the -

CHAIR: You are not suggesting that we have done an investigation to date when there's only been a technical breach?

MR ALSOP: We are certainly not suggesting that, and if that did be the case, we think it would send unfortunate reflections on the Commission's approach in relation to its breaches.

MR MURASHEV: Moving on to the slide dealing with synergies between the Electricity Commission and the Commerce Commission. We think that these are limited at present but they will definitely increase over time and become an important issue.

While Vector is happy to provide information to either Commission separately, if and when required, we do support the Commissions working closely together to ensure there are no duplicated requirements.

We see limited consideration to date of how the Electricity Commission's work will promote the outcome of the Commission is required to achieve.

We think the Electricity Commission's work on standardised pricing methodologies and model distribution agreements is relevant.

I think this was touched on by Genesis yesterday.

We think that a consideration of these sorts of issues needs to occur as soon as possible before any further disclosures are required.

The need for these sorts of considerations is further

underscored by the possible transfer of the Part 4 regime to the Commission in 2009. We support those lines of communication being open and we think the cross-appointments are a good tool for that.

MR TAYLOR: Just one clarification, coming back to your compliance information slide.

You used an expression, I didn't quite pick up the second bit. You were talking about breaches, technical, and I thought you said "technical and not the fault of"?

MR MURASHEV: "Unintentional".

MR TAYLOR: Unintentional, that was the word, thank you.

MR ALSOP: The summary slide replicates what John ran through at the front end so I don't propose to dwell on it.

We would like to note Simon McKenzie conveys his apologies to the Commission, he is overseas. The Commission is used to seeing Simon in this context so I wanted to close off any thoughts about this issue.

That is the full Vector presentation. We do appreciate the opportunity to run through that substantially uninterrupted and welcome the discussion and Commission's questions.

CHAIR: Thank you very much to all of you for your summaries.

I would like to start off with questions evolving round the issue of the purpose of the disclosure regime and Commissioner Bates will start the questions on that matter.

MS BATES: Anton, these questions are largely addressed to you, but some may run into some of the initial submissions put forward by Peter and I don't really mind who answers, quite frankly.

Anton, one of the things you said was the purpose under sub-Part 1 and sub-Part 3 was really quite broad, and you referred to the wording at the beginning of the purpose statement in 57T. I don't know if you've got the

Act there or not.

MR MURASHEV: Sorry, I haven't.

MS BATES: You are probably very familiar with it, probably more than me. The lines under the broad purpose statement are quite specific, wouldn't you agree, in terms of the purpose of ensuring that a range of people receive information about quite specific aspects of the businesses?

MR ALSOP: Maybe I can first and Anton can add his thoughts. A wide range of people will certainly be addressed by even a very de minimus approach for disclosure because by its nature it would be publicly available and transparent and therefore all can review it.

MS BATES: There's a wide range of people, so not just consumers within that. It could be yesterday we heard from Genesis and people like that who are interested.

MR ALSOP: Sure.

MS BATES: And some of the ELBs claim to be interested and others see it as of more limited value. So, there's a range of people. They might have different needs even in terms of the level of information.

MR ALSOP: Sure.

MS BATES: And then, of course, there's the scope of that information which, although you seem to have emphasised price and quality as being something consumers would be interested in, the purpose statement itself goes quite a bit broader than that?

MR ALSOP: In terms of the ambit of parties, I mean that cuts directly to what Vector has called the needs assessment in terms of better understanding from those parties exactly what they need and why.

In terms of the, sort of, ambit of the list of performance measures, the second part of your question, in our view, my recollection is that purpose statement refers

to, sort of, factors such as -

MS BATES: Profits, costs, assets values, price.

MR ALSOP: I wish to emphasise the "such as". It's giving some examples of things that might be useful, and I emphasise "might", to some people. It doesn't require that each and every one of those things in the purpose statement should be subject to disclosure.

MS BATES: With respect, Peter, that's a debatable point of statutory interpretation and there would be a strong argument that you're wrong on that, as you are no doubt aware. That's certainly not a cut and dried issue, is it?

MR ALSOP: Many legal issues in interpretations.

MR MURASHEV: I would like to add to Peter's point, he started on the point I was trying to make.

The part that comes first in the purpose is to do with the relative performance, and I understand that it's a legal point of what "such as" means, but I would like to bring you back to the purpose of sub-Part 1, and there the tool is thresholds and control and they've set out the exact incentives that should be there. It doesn't say "incentives such as to have efficiency gains", "such as to share those gains". It lists them in specific sub-paragraphs and it says these are the things thou shalt ensure.

MS BATES: That's in sub-Part 1 you're talking about.

MR MURASHEV: The purpose is similar and only the tool is different.

MS BATES: The point is you've said it's a broad purpose statement. My argument to you would be it's not actually broad, it's quite specific what has to be done.

MR MURASHEV: I guess we just don't agree on that point.

MS BATES: Okay. But it's certainly - you were just taking two lines of it without going into the drilling down, into the more detailed purpose that was put there.

The reason I put this to you is not just to have an argument about what the words might or might not mean, but you come to the conclusion that the over-arching purpose of the disclosure regime is to inform the thresholds regime. Whereas, I put it to you that there is another purpose that that might be one of the purposes but the stated purpose is actually the public disclosure.

MR ALSOP: That comes back to the two more lines of what we'd

see of primary importance in the purpose, Commissioner Bates, which is the promotion of efficient outcomes, I don't know the exact words, but efficient outcomes over time, which is the regime working holistically to move to the -

MR MURASHEV: We think by inference, information that will be disclosed in order to support the setting and evolving of thresholds that satisfy the overall purpose of Part 4A, that information will almost by definition provide the right information on the sorts of things that -

MS BATES: It doesn't take away the Commission's obligations -

MR MURASHEV: But it satisfies them in our view.

MS BATES: Can you please just let me finish when I'm talking.

It doesn't take away the obligations as statutory obligations the Commission has under Part 4A to make public disclosure, and they're really quite specific:

"Must require large line owners and electricity distributors to disclose information."

And then again in section 57V:

"Must give summaries and analysis of that information for the purpose of promoting greater understanding of the relative performance."

And that gets back again to the purpose being something additional to simply supporting the threshold's regime, although I wouldn't argue it's unrelated to it, it's the whole package you get.

MR ALSOP: The Commission needs to do certain things in principles. There has to be a summary analysis. There has to be a disclosure regime of some point. We are just parting view on the extent and it is our contention that the Commission has a degree of flexibility open to it to achieve those principles with different approaches at the level of detail.

MS BATES: That's what I'm coming to next because I just wanted to set the scene to where we might go to.

MR ALSOP: Okay.

MS BATES: This is something you put forward, Peter, that what we were proposing was too intrusive, that the extent of the detail required was not clear. You said both of those things, I think, did you?

MR ALSOP: I guess there is quite a degree of clarity of what's envisaged by the Commission. The Commission itself is still at the proposal level. It signalled some workshops might be necessary to flesh out some levels of detail. It's also possible the disclosure regime will evolve over time. If it's already detailed at the front end, it needs to be more detailed going forward.

MS BATES: Let me ask you if you can, just by way of illustration - we are trying to get down to what it is that you are actually suggesting we do in terms of this regime.

You said you think the regime that we are recommending is too intrusive.

MR ALSOP: (Nods).

MS BATES: I would like to ask you if you can give an example or two of what you mean, so we understand where you're coming from; what level of detail perhaps we've asked for and what you think is appropriate in any area?

MR ALSOP: Nathan may be able to give a couple of others. One is the proposed disaggregation into looking for

granularity within network areas, particularly where they are non-contiguous.

That raises the question as to why stop there? If there's two networks that aren't non-contiguous, should they be separately reported on? Should customer classes within those areas which are non-contiguous areas within a network, should they be disclosed on?

MS BATES: And your view?

MR ALSOP: Absolutely not.

MS BATES: Because we had people, and I will just put this to you, I think you were there yesterday, were you?

MR ALSOP: I escaped some of it but I was there for some of it too.

MS BATES: Some people put to us that they thought that further disaggregation was needed to make the information more meaningful to various classes of people, and perhaps fulfil the purpose of making the whole thing more understandable, but you don't agree with that?

MR ALSOP: No. I did hear some of the comments that Genesis, which may be what you're referring to -

MS BATES: I don't think it was just Genesis, but I can remember -

MR ALSOP: It almost was quite revealing as Brian Furness spoke, that he spoke with passion about all these other things that in his view could usefully be disclosed and then he stumbled saying, "Oh, we're sort of getting into setting thresholds now." And that's exactly the sentiment we're trying to put in our presentation, there's grave risk to the Commission through disclosure and well intention but with the adverse consequence of creating what we're calling as de facto thresholds, diverting attention from the thresholds we have today and therefore in a strategic sense, unravelling its unique regulatory structure that we all have to work with.

MS BATES: So, your argument is that we go beyond what - not go beyond what's already being disclosed under the current regime, is that about the level of disclosure you think appropriate?

MR ALSOP: Possibly less in an ideal world from our perspective, the disclosure would support the threshold reset methodology in 2009.

For the initial threshold setting methodology, it was largely based on disclosure, not exclusively, and that was only a subset of disclosures that we now have.

So, ideally, it would be linked to that 2009 methodology which, as I noted in my slides, is, in our view, of high order importance to the detail that we're discussing.

I just want to make one further comment, Commissioner, about some of the remarks that Genesis made was you have to ask the question as to what extent those could be addressed by other means.

I think it was the Commission Chair that put to Genesis, contracts with these people, why can't you get this information through contracts?

I checked with some of the guys through our organisation today that work on the business model and interface between list lines businesses and retailers, their views are those discussions are ongoing continually. They pointed pretty immediately to the process led by the Electricity Commission to evolve the model use system agreements and the detail that they could build into, I am not familiar with the detail myself, there is detail in there. There could be more as that process runs its course.

There's one further thing I wanted to note. Vector itself is going through our business model projects. As I think the Commission knows, we operate the conveyance to

the Vector Auckland network, we contract direct with end consumers. We also have the interpose model question, the Genesis spokespeople were probably speaking more to where they're interposed between Vector and the customer.

Our business model project takes an objective fresh look at both those models, and they've both got pros and cons, but we're trying to weigh those up, consulting with retailers and other stakeholders to try and arrive at a business model will then feed into contracts, will feed into the work the Electricity Commission is doing on those same sorts of issues, model distribution agreements.

Right there is an avenue for retailers to contractually extract more information from us.

Our argument is not that the information doesn't exist. As Mike Underhill from WEL put to the Commission yesterday, anyone that runs state of the art SCADA systems has extensive amount of information about their feeders. We have 1,800 feeders and real time information coming back. For us it comes back to, who wants the information? Why do they want it? What are the other means for them to get it? Can the Commission, if they need it for investigation, use section 98? Yes, it can. What is the incremental value to having the information disclosure regime drilling more and more down into detail? That's where our holistic stuff -

MS BATES: It's getting the balance right in making a meaningful disclosure to the groups of people that use the information.

MR ALSOP: Yeah, as long as their need is robustly assessed as something - I mean, if it's just important to them, I think the information is useful, we would be keen to know about that and have a view on it.

MS BATES: You would be keen for us to do research before we go into this; this is your point?

MR ALSOP: Absolutely. We think the development of the disclosure regime, if it is to be broader than our suggested purpose of setting and resetting thresholds, that a needs assessment is absolutely critical.

MS BATES: There's certainly a very good argument on the wording. It seems to me there's an obligation to monitor it to promote greater understanding of the relative performance. So, suggesting information has to be at least able to allow us to fulfil that purpose.

MR STRONG: If I could offer a perspective, both as one who's tried to do productivity benchmarking as well as somebody who consumes electricity.

I mean, from the perspective of trying to do benchmarking modelling, you know, one of the key areas in that is, are you comparing like with like, and have you got robust information to support that comparative analysis?

You know, looking at some of the suggestions in the discussion paper, I mean just to pick up one, there was a suggestion that you may need labour cost information and a number of employees.

In terms of thinking about, "Well, could I use that information to go into a model that would tell me something about relative performance?", I mean, it occurred to me that, well, measuring all those things is really difficult and there's quite a lot of trade-offs at the margin between, you know, do you outsource various things? Can you measure the labour expense? What happens if the organisation that you contract to uses more employees than you're actually paying for because they fix their costs or their prices wrong? There's all those sorts of considerations.

So, if I look at that particular piece of data, I think, "Well, maybe that wouldn't be useful to me." A

higher level of aggregation would be appropriate.

So, I think, you mean, your suggestion that you perhaps need to do some research into -

MS BATES: It wasn't my suggestion. I was saying that was your suggestion.

MR STRONG: Well, okay. It would be a suggestion that I would also make.

MS BATES: I think it was - I wasn't saying that it was our suggestion. I was saying that you seem to be suggesting it.

MR STRONG: Sure. What I am saying is that you need to sit in the shoes of a practitioner to think about how you might actually use this information and what level of aggregation or disaggregation is going to be appropriate to a robust benchmarking process.

CHAIR: I think, then, the practitioners who had to oversee the development of a benchmarking approach, I think probably have been in those shoes.

MR STRONG: Absolutely, and so you probably have a perspective on what the right level of disaggregation might be.

CHAIR: I've been interested in Vector's position on the purpose of disclosure. I am a little surprised, I must say, because I have no difficulty with the notion that we need to think carefully about the benefits you get from greater complexity of disclosure, and what it's going to be used for and the incentives that you setup, and I think we will be very mindful of those things.

It's very easy in an initial document to put down everything you might think about. It doesn't mean that's where you're going to end up.

So, I take those points.

What I am having trouble with, however, and the Vector position, as I understand it, is the thought that the information disclosure regime should be thought of as

something incremental to what is - what seems to be to you the primary tool under this legislation, which is the threshold regime, it's certainly that way now. I mean, right now the threshold regime is the main driver in the regulatory environment.

But I wonder if it's not a dangerous thing to let ourselves think that that's the way it always has to be or should be.

I, myself, don't see any reason why in the future as companies adjust to the threshold regime, that the threshold regime may play a lesser role in the regulatory environment, say, compared to information disclosure.

So, if I think of information disclosure and its role, I don't see it as a once and for all, you know, it would be the same today as it might be tomorrow, or it was yesterday.

I think there's a real danger if you look at it in the way you have, where you think of it as an increment to the threshold regime, incremental, you overlook a similar cost benefit analysis that says, if you're trying to impact behaviour in this industry, what's the least cost way to do it? Is it through the threshold regime or is it through the information disclosure regime?

And I might argue to you that in many cases it's far more cost effective to influence behaviour through the information disclosure regime in the future than it might be through investigations, the threshold regime, control investigation or absolute control.

So, for instance, the point you make about trying to move the pack in a certain direction, if we can signal to you what we think are issues. For instance, this sub-network issue. We can signal it to you and you can either take it on board or not. Some companies are taking it on board and some are not.

We can do it the hard way or we can do it the easy way, which is something we've made very clear in the past.

Now, me saying that, or the Commission saying that, might incentivise some of you and it may not.

Well, what is the alternative if it doesn't? And we think it needs to be addressed. Is it to do it through the threshold regime and possibly through control? It's very costly.

If I compare that alternative to the alternative of us suggesting to you, and not only us suggesting it to you but consumers out there having good information, and also exerting their countervailing power on you, and what the likely costliness of either approach would be, I'm afraid my money might be with using the information disclosure as being a far more cost effective way for the Commission to incentivise players to move in a particular direction.

So, I'd like you to respond to that because we do give a lot of thought as to where the regime might go, and it seems to me that for some companies it may well be that the targeting regime is going to be the primary tool for some time, but I am also very mindful that there's a very large group of companies for whom it is very intrusive and probably not cost effective and reliance on information disclosure in the future may be far more appropriate.

So, I have a different view on the role information disclosure in this regime as we go forward and we would like your view because, as I said, I am a little bit surprised.

MR ALSOP: Okay. We have got a dollar on the other approach, as outlined.

As you were talking, Commission Chair, it almost felt like you were describing the regulatory regime that we used to have, that was based on information disclosure, incentivising behaviour. If disclosure was seen as the

silver bullet to pushing things in the right direction and achieving desirable outcomes, whatever they may be, then perhaps we as a country, it's probably a fruitless comment to make now, should have advanced the information disclosure regime or done a more critical needs assessment of that before the thresholds kick off.

I also had a feeling as you were talking that it actually cut to and perhaps even were agreeing about the need for the holistic assessment of the thresholds working with the disclosure regime because the way the statute is setup, the Commission has no choice but to set thresholds and reset thresholds over time.

So, that's a must. That's taken as a given.

It does, in principle, have to set disclosure, as Commissioner Bates has questioned us on, so no disagreement there.

It does cut to that holistic assessment. Given we have the thresholds, we do have this unique regulatory environment in Part 4A that requires thresholds to be set.

So, we see that as the flagship of the regime and we feel that it's appropriately the flagship of the regime, particularly the positive approach the Commission has taken to implementing that to focusing on things consumers really care about, price and quality, and the innovative approach of ranking lines businesses to setup an artificial competition to get the best rankings.

We are a strong supporter of thresholds in concept, including the way at the conceptual level, some niggles in the detail, but at the conceptual level we support the Commission's methodologies.

So, the thresholds are a given, that brings us back to our strategic thoughts. Given those are there and they are going to be reset in 2009, what can we do at the disclosure level that preserves the threshold mechanism

working carefully? That's where we see the real risk emerging.

CHAIR: I just want to pick you up on that because thresholds are there and that's right, but the way we do thresholds today, there's nothing in the Act that says it has to be done that way in the future.

So, we may have to set thresholds, but how we set them can be done and the way we assess compliance against them can be changed.

In that sense, we may have - and I certainly agree with you, preserving the targeted regime has some merits to it, strong merits, but it seems to me the information disclosure regime, depending on the behaviour of the companies in this period, has the potential to allow us, at least for some of the companies, and maybe a large number of them, to move to a more targeted regime and a less intrusive regime in terms of the way we go about assessment and compliance.

And so, this is not - when I say to you we can rely on the information disclosure regime in some additional ways in the future, it's not premised on the idea that we'll go back to the way it used to be where there was no threshold regime, but nevertheless we may with those companies be able to rely on the information disclosure regime to discipline them in a more cost effective way than resorting to investigations under the threshold regime. We still have the thresholds but we may have far fewer compliance statements required. They may be required once in the reset period for some of the things.

MR ALSOP: An additional angle on the incentives for compliance, is the Commission's incentives - is the Commission's response to threshold breaches, given a caveat on our view that those should be breaches that are caused by the lines businesses, not triggered by other

things. But, I mean, you made a comment that the Commission can make noises about some issues like the regional disaggregation one, I think it was, and some people would take notice of that, as Vector has. The Commission is aware we've undertaken a phase three balance between network areas, not largely, but the Commission's view on that matter was certainly a consideration that the board took strong cognisance of.

You made a comment that some may not take heed of the Commission's warning bells, for lack of a better expression, they certainly do that at their own peril and the Commission, through an investigation, I don't know whether it's a current one of companies under investigation now or a future one, that will send - the way the Commission responds to that will send very strong incentives that will feedback into the incentives inherent in the Part 4A processes.

I am probably belabouring the point but we really feel strongly about the processes inherent in the Act, that the three phases exist in our view for very sound reasons, and the three phases and the different aspects of them together are very strong incentives to deliver on the purpose statement without the need for getting into detail on disclosure.

We keep coming back to it.

CHAIR: Let me ask you this, Peter. In the case of this issue of sub-network level activity, do you think that if we had disclosed information on this particular matter, do you think, if you compare the costs, the net cost of addressing that issue through improved pressure by those affected along with urgings from the Commission, do you not think that might be more cost effective than having to go through a whole reset period, changing the whole approach we do to thresholds, and everything that involves

imposing that on all companies, all companies, all 28 companies, not just the three or four that might be involved in this matter, do you really think that has net efficiency benefits?

MR ALSOP: I guess in response to that, we'd say what might be more cost effective than what you're pointing out is the facilitative type approach Vector is advocating. A couple of speeches from the Commission Chair did -

CHAIR: And if that fails, then which of the two remain as options, or is there another option?

MR ALSOP: Which of the remaining options, is the businesses that failed to take heed of robustly analysed issues and identified problems from the Commission do so at their peril and the investigation and control phase, which in turn feeds back into further incentivising other people.

CHAIR: You only get there if it's reflected in the threshold regime and reflected in the threshold regime you have to change the rules for all 28 companies. What you're saying to me doesn't address that unless those companies happen to breach for another unrelated reason.

On that particular point, I might remind you that Vector's position is it shouldn't investigate unless the investigation relates to the cause of the breach.

So, in the approach that you support, we would never address those issues.

MR ALSOP: No. You would address them but you might address them slightly slower.

I refer back to the diagram we put up and Vector unashamedly says the facilitative outputs type approach that we are advocating may, in the short-term, not elicit the same degree of gains that the Commission could, from detailed disclosure and other interventions if it chose, in the short-term. But that needs to be weighed against the longer term benefits of what we're advocating.

CHAIR: So, in your model, how does it get addressed in the longer term?

MR ALSOP: Well, you've got the C1 factor for relative productivity. We currently have C2 factor. The methodology could evolve into further linking price and quality. The thresholds have a natural evolution, become more sophisticated and the methodology used to set them. We maintain they still should be set at an aggregate level because it's moving things in the right direction.

CHAIR: How would that issue then be addressed through the reset process, because that's what you're talking about, at the reset point you can do something with the thresholds to pick up that point if we felt we needed to.

MR ALSOP: Without setting -

CHAIR: I don't want you to tell me how we would do it in detail but what I am trying to ask you, is it not then at that point necessary to change the regime for all 28 companies in order to deal with the behaviour of three or four?

MR ALSOP: If you explicitly want to address the issue, I mean, short of setting an area specific threshold, or a customer class threshold, the current threshold may not be able to address the issue because of its average nature.

CHAIR: This is what I'm trying to get you to focus on in terms of the costs and the costs we impose on the whole industry, compared with do we net through information disclosure?

MR ALSOP: But there's an important aspect of the processes incentivising people addressing issues over time.

As we reflected on the discussion paper and issues related to it, it almost felt to us like there was an impatience on the Commission's part to feel like it had achieved the one and only specific interpretation of the purpose statement, year on year we have to do X, X, X.

In our view, the philosophy of the regime is very much over time, putting 28/29 companies in the right direction, incentivising synergy gains which is arguably the biggest gain the regime could make for New Zealand. So, it just comes back to our take on the philosophy of the regime.

CHAIR: I understand what you're saying and that aspect I will agree with you on, and I don't think the Commission has moved away from that.

But I think that where we are different here is that the Commission sees a need to weigh up the relative cost effectiveness of using information disclosure, as opposed to the threshold regime, to affect behaviour.

And if we find that it's least costly to do through information disclosure, then it seems to me a valid thing to rely on that, rather than not only using the thresholds then it might be more costly and it may take longer.

It seems to me like that's a path we don't want to go down.

So, it sounds to me like we disagree about the cost effectiveness of using information disclosure.

MR ALSOP: I would agree with what you just said, provided the sort of net benefit or cost assessment reflects the possible implications of the disclosure for the other parts of the regime.

If that's what the assessment includes, then we're on the same page and we are putting up the warning bells about those feedback mechanisms. That's probably where the disclosure debate is won or lost or the decision is made one way or the other.

MR MURASHEV: That sort of trade-off between the thresholds and the information disclosure regime achieving different outcomes and how much you weigh on what, that didn't come through, at least from our reading of the Commission's

paper. If we had understood that this is where the Commission's thinking was at, I think our response may have been slightly different if we had more time to consider those sorts of trade-offs.

CHAIR: I think it would be helpful if you do think about that because I am not saying they are trade-offs between two of the same, we have both instruments, and when we think about what we're trying to achieve under the regime, what is the most cost effective way to do it. And that may change through time depending on the behaviour of the company.

So, I think it would be good if you could give some thought to that and come back to us because I suspect there may not be as much disagreement as it might seem at the beginning of the meeting today, but I would be grateful for you to think about it.

We've gone 10 minutes over the time for this part of the session and we do need to break to give 15 minutes rest to the stenographers. So, I'd like to suggest we break now and we will start promptly at 3.25 and I would be grateful if Vector could be available.

Conference adjourned from 3.10 p.m. until 3.25 p.m.

CHAIR: Okay. We will reconvene this session with Vector. I would now like to hand the questioning over to Commissioner Taylor, please.

MR TAYLOR: Just a question for Nathan on the ACAM conversation. I will refer, you probably haven't got it in front of you, para 322, you no doubt have it in your mind, of the submission which discusses and mentions the approach of allocating only incremental costs to the non-monopoly business concerns the Commission on two counts.

I just want you to react to these two counts. It allows the business to retain all of the efficiency

benefits that might be achieved through economies of scope. This is efficiencies inconsistent with the provisions of Part 4A which require efficiency gains to be shared with the customers over time. It is that particular thrust which I just wonder if you might react to particularly against the confession of your previous remarks? You see the thrust of where I'm going?

MR STRONG: In principle, the ACAM method would allow that, and I guess what the issue here is, it comes back to that trade-off between dynamic and static efficiency. I mean, tomorrow the Commission might quite like all of the lines businesses to be earning their WACC and no more. But if you were to put in place such an approach, that would deter businesses from making efficiency gains.

So, the issue comes down, or back to that trade-off, of, you know, what is - from New Zealand's point of view, what is the method that most promotes long-term benefits for markets?

I mean, at the end of the day, consumers in the economy act as both providers of inputs to firms, as well as consumers of those firms.

And so, in a sense, you know, consumers are gaining from those efficiency gains that are earned in the long-term.

So, I wouldn't say that, you know, under that method that there is no sharing of efficiency gains.

MR TAYLOR: It's one step removed from Part 4A, perhaps quite a long step from Part 4A, would it not, which requires efficiency gains to be shared with customers over time?

MR STRONG: But where are the efficiency gains emerging?, I guess is the question.

Under the ACAM method as it is applied to the electricity sector, or to the lines businesses, mergers between lines businesses must result in those efficiency

gains being shared because the businesses are not treated separately.

MR TAYLOR: Sure, yeah.

MR STRONG: So, the economies of scope that are gained through lines businesses merging are shared with consumers. I mean, that happens.

MR ALSOP: Can I think about it in terms of ACAM, but if another method or a variant of whatever - another method or some variant of ACAM prescription or otherwise was implemented, that could be counter to the sort of issue that you're raising about promoting efficiency?

MR TAYLOR: Stick with ACAM. I did preface it by referring to non-monopoly businesses. I take the point about the merger issue but it was specifically with regard to non-monopoly.

MR STRONG: Right. And so, if a lines business makes an efficiency gain in another business by being able to avoid some of the common costs that it is currently paying, then that would presumably be outside of that definition.

MR TAYLOR: Well, that's the question, isn't it? Your proposition is that it should be, I think?

MR STRONG: Yes, that's right.

MR TAYLOR: The query in our paper was, is that in conform with Part 4A, and I was asking you to react to that and I take it that you have?

MR STRONG: Yes.

MR HEMMINGWAY: In your submission in paragraph 57, the first submission, you discuss - you say that Part 4A regime ring fences lines businesses. I wonder if you could describe and elaborate on that statement because you didn't go into it in any detail.

MR ALSOP: To me, Commissioner Hemmingway, that gives a related answer to Commissioner Taylor's question, that for efficiency gains within the electricity lines businesses

they clearly get shared with consumers over time. The ring fencing pertains to the electricity lines business.

In the presentation I gave, it was the counterfactual that we put and suggested the Commission give strong credence to, that counterfactual being that if a lines business decided to just be an electricity lines business - (cellphone ringing) - sorry, that's me. Sorry about that.

If a lines business decided just to be a lines business, then the Commission regime appropriately allows and respects that lines business recovering stand-alone cost of running that business. It is within that context that we are referring to ring fencing.

MR HEMMINGWAY: Are you familiar with the situation in the US where the lines retailers are probably about half the sectors now, either unable to finance or close to being unable to finance because of investments in non-core businesses and that essentially were outside the sight of the regulators?

I don't want to get into a dispute with you at this stage about what should be disclosed, but how should the regulator discover when the non-electricity businesses are causing a problem for the lines business?

MR ALSOP: I guess when those problems emerge and are identified and robustly worked through.

To the extent that other business activities should be specifically off limits for investment, as we noted in our presentation, that could have been addressed by the EIRA, or still could be if there was a view from the Commission or anyone else that wanted to promulgate it that other business activities should be specifically off limits because the risks to the core electricity business are so great, or the alleged anti-competitive effects of, sort of, being involved in other markets are so great,

that that risk is there.

We're not - we haven't yet seen rigorous analysis that problems or concerns exist. We are not aware of any complaints regarding competitive advantage of lines companies and other non-regulated businesses; nor have we heard of any complaints in the threshold regime about the comparative mechanism for setting C2 factors of which cost allocation directly feeds into that.

I guess it comes down to tangible specific complaints or problems that are analysed, rather than a theoretical discussion about ACAM, bearing in mind the inherent risks we see in moving away from ACAM.

I hope I've answered your question.

MR HEMMINGWAY: I just will have - I am not at this stage terribly conversed in the details of the regulatory regime that the Commerce Commission has developed, I am trying to get there, but one of the principles that I will be following is trying to ensure that monopoly lines businesses don't end up jeopardising their consumers by investing in businesses that get them into trouble, and then having being unable to conduct its business because it no longer has the financial capability.

MR ALSOP: I guess it's a valid concern to raise. A further response is that thresholds from the service quality level are trying to move things in the right direction. The asset management plans are out there and there are discussions on those surrounding investment/re-investment maintenance on the networks.

There are also the natural incentives, corporate reputation. Vector through its predecessor companies knows that all too well. I'm sure other companies have looked at that and thought, "Not us."

So, obvious day-to-day sort of market corporate pressures that exist as well.

MR HEMMINGWAY: There's been a great deal of discussion about essentially good businesses and whether consumers should share in the benefits of those businesses, but I think the bigger issue really is what happens when something goes wrong?

MR STRONG: I mean, it's sort of quite a different issue really for a regulator to address. I mean, New Zealand is a small open economy with fairly scarce, you know, capital and labour resources.

So, you know, there is a tension between having businesses grow and take advantage of scale and scope economies, against maybe the risk of those other businesses impinging on the activities.

I think that's, sort of, quite a - it's a very difficult high level policy issue to address but, I mean, it's something that's quite hard for a regulator, I guess, to deal with. It gets into business decision-making, "Is this too risky a venture to get into as a lines business?" It sort of really is blurring the lines between appropriate business activities and, you know, the legitimate interests of the regulator.

MR ALSOP: It's probably stating the obvious to also suggest the regulatory regime in the sense it creates for investment in the lines business itself, an adequate recovery of the true and efficient cost of investment, which Duncan spoke to in the context of our asset valuation, that's also quite critical and very central to the issue you're raising about there being sufficient investment on an ongoing basis to ensure the lights stay on, which at the end of the day certainly has a common interest and agreement in the outcome.

CHAIR: I will ask Paul Sell now to ask questions.

MR SELL: The first question I have is about the disclosure of efficiency information. I think you've taken the view

that the information, as have several other submitters, that price and quality are the main things that consumers are interested in.

I guess my question would be, what use is it to disclose only price, let's say, let's put quality to one side, if consumers or stakeholders in that information have no information about the underlying efficiency of the business? Can they make any sense or get any sensible meaning from that price information without some other input information?

MR ALSOP: The initial answer from me is they may or may not but the question cannot be seen in isolation from the thresholds that exist.

Jump back on my bandwagon. There was a C1 factor which is about relative productivity that exists within the thresholds concepts, it was evaluated in 2004, a year or so ago, it's well documented what the hierarchy of good to bad is. Companies exist that there will be some sort of similar mechanism in 2009. It is that that we think should be pointed to rather than any other disaggregated measures or others through the regulatory period.

Nathan -

MR STRONG: I guess I'm struggling to understand the question a bit. I mean, I think it is difficult -

MR VAN BRINK: Can I add a little bit here? I think once you start looking at consumers trying to identify whether they're getting a good deal or not, for example in terms of pricing, the issue becomes extremely complex and I think more so, more it was, that's available. By talking to consumers who have trouble with supply, for example, and wanting to know why they're paying a certain price and yet they're getting a certain number of interruptions, for example in remote rural areas, to talk to them about the geography, the implications of overhead lines and trees,

national passion or whatever, a whole lot of reasons why things may be different to a consumer comes across as an excuse.

I think the best mechanism for ensuring consumers feel comfortable they're getting a good deal in terms of price or price quality trade-off, is really through a regime such as a threshold regime where an expert body actually identifies the levels of pricing or price path.

I have some concerns about having a large amount of disclosed information available for consumers to wade through as a group or individually without suitable understanding of the underlying conditions that would generate figures.

One good example I could mention would be in northwest Auckland where we have what we term to be an industrial rural feeder. It is a single feeder which supplies one of New Zealand's largest shopping malls, a large processing plant, and attached something like 80 kilometres of very remote rural feed in the west coast of Auckland. Trying to identify the implications of the different level of supply to customers in rural areas compared to urban areas when they're on the same feeder becomes more complex unless you're a bit more expert in the area.

MR SELL: Thanks for that. I would note that I wasn't really making a disaggregation point here. I was really just thinking about the business in aggregate.

I would like to come back to the response that you gave, Peter, about the - that the threshold regime provides us with information on efficiency because that only applies every five years.

The obvious question is, what happens in the meantime? Do we simply shut our eyes and hope?

MR MURASHEV: If I can try to answer that one. I think that

it's not just the threshold regime on its own, it's the performance of the companies under that regime.

So, in the meantime in the five years you will see companies breaching, the Commission looking in and saying whether or not that breach, in essence, was efficient. If the Commission looks into a breach and decides there were good reasons for it and the company's performance is efficient, that is something that is publicly disclosed and something the consumers will take into account.

Likewise, if companies do not breach and the Commission's thresholds would move everyone towards their achievement of the purpose and efficient performance. That in itself sends a signal that the performance of the companies that don't breach is efficient and that is what we think the main tool is, for the customers to have the confidence that their performance is efficient. They will see that through the performance of the lines business through the thresholds rather than wading through pages and pages of information that they may not necessarily know how to interpret. I think that was the point John was trying to make.

MR ALSOP: Just if I could add to that, I ask the open question as to why do we care specifically during the regulatory period? Is the suggestion that the threshold that is being set, so presumably purpose statement compliant in the Commission's view, with the C1 factor that focuses on relative productivity, does that suggest through five year regulatory period the Commission feels it wouldn't be purpose statement compliant?

We have a regulatory period for a reason, to provide some level of certainty that businesses can get on running their businesses within the price path set by the Commission, unless it's sufficient for them to breach.

I go back to an earlier comment, to the extent

there's further concerns about productivity, the best thing we can do as a group is work together on a reset methodology for 2009, focus information around that methodology so there's certainty going beyond that to drive the efficiency gains that I think you're referring to.

MR SELL: I don't think this is the time to get into a debate about whether people are interested in efficiency information.

I guess we've taken it as a working assumption that parties would be.

So, our question really is, if they are, why should they wait five years for the information?

I think I do need to respond to a point that you made before, Anton, about what if they don't breach? You seem to be saying that that was evidence that they are efficient.

I mean, the threshold breach is really just solely price based. Having been set, it's price based. I would suggest that it's not actually telling us anything about whether they're efficient or not.

We really only get that information in the event of a breach.

So, I think unless you have any further response to that -

MR ALSOP: The information that was used to feed into the C1 factor of course trundles on at the moment as an information disclosure requirement, my understanding.

If there's a view that the existing disclosures that were used for the productivity assessment aren't sufficient, then there should be a discussion on detail as to what other information disclosure factors on productivity are required, but the requirement being feed into the reset methodology related to relative

productivity performance.

MR SELL: Well, actually that's a good lead in to what was going to be my next question to you.

You made a comment on one of your slides that your preference was to have no disclosure. I think there's been quite a bit of comment earlier about the statutory need for disclosure, or if there was no disclosure, to continue with the existing regime unless the Commission was able to prove that that should be improved on.

I think that was the slide on page 6.

MR ALSOP: I think it is important to clarify, the Vector proposal is not that there be no disclosure at all. There should be disclosure to feed into the setting and resetting of thresholds to support the C1 and C2 assessment and anything else that's reasonably required to set and reset thresholds over time.

That is a portion of the existing information disclosure set. We are saying some of that wasn't used to set thresholds, therefore let's have a need assessment around its ongoing requirement.

I want to be very clear, it is not Vector's requirement that there is zero information disclosure.

MR MURASHEV: I think I know the slide you are referring to. It might be just an interpretation issue.

We are saying that when you are looking at a new disclosure requirement, or changing disclosure requirement, moving away from a status quo, you should consider the incremental benefit and the current disclosure referred to the status quo.

If you are looking at introducing a new disclosure, you should look at what the incremental benefits of that are over the current situation, whether that's currently no disclosure, as is the case with some of the additional things disclosed in this paper, or moving from something

that would currently have and making it more detailed.

That's what that reference was.

So, it's just looking at a specific disclosure, looking at the status quo, whatever that might be at the time. That wasn't a general reference to the whole regime.

MR SELL: I suspect, and I think the discussion paper signalled this, we may be looking at moving towards something that's less detailed, but I inferred from your slide that you're actually quite comfortable with the existing regime and you prefer to simply continue providing that information?

MR ALSOP: Just a tweak on that. I mean, the existing regime was put to good use in the setting of thresholds. Was it used in entirety? No. It was a subset. My understanding was - I am not a king of detail, but my understanding is there was some information that wasn't in the disclosure set that was required for the methodology to set the thresholds.

It's an existing 100% of the existing set, maybe 80% or 60% was used for setting the thresholds. So, let's cut to the chase and say that's a given. What's the needs assessment around the remaining 40%, and importantly, a robust needs assessment around any increments to the existing disclosure regime?

Let's not just let the existing disclosures stay sitting there for the sake of it if they're not being used to set and reset thresholds.

MR SELL: I think we are on the same page on that.

MR ALSOP: I am sorry if our submission is misleading or has been confusing. That slide probably did complicate or confuse our explanation. But I hope with those clarifications it's clear where we're coming from.

MR SELL: Yes thanks. There's one other question that I would like to address to Joanna Perry.

You seem to be going further than I think most other submitters did on the use of GAAP. I think most other submitters said - maintain consistency with GAAP but no problem with additional prescription.

I just wanted to clarify whether I heard right or interpreted what you said correctly, that you didn't seem to see any great need for greater prescription either?

MS PERRY: I would certainly say that any added prescription should be looked at very carefully to ensure that it really is necessary, in that GAAP in theory is supposed to provide the comparability and all of the reliability, the relevance, etc., etc., etc. for users of financial statements.

Therefore, in theory there should be no need for additional prescription and, therefore, yes, I would support the fact that there should be none.

Yes, in some instances there may occasionally be the need to say, okay, there is a choice, there is an interpretation with GAAP, for the absolute true comparability we really perhaps need to say, "Don't take that choice, take that choice instead."

But I would go so far as to say I don't see why there should be any additional prescription.

MR SELL: Okay. Well, it's useful to get your view and I guess the only way to progress that further, I guess, is to get into the detail and it's not the right time to do that.

CHAIR: Just if I could ask one follow-up, Paul, on that.

You said it had met all the various requirements for someone who's looking at financial statements. Have you done a detailed analysis of whether that's the same thing as required by a regulator when looking at it for the purposes of regulating a particular industry, given the purpose that we have, which is not necessarily the same purpose that somebody who would use financial statements

has put into use the information?

MS PERRY: I haven't done a detailed assessment or a detailed research in relation to that.

Reading your discussion paper and the work that I have done in practice over the years, would indicate to me in relation to, in particular, those identifications of areas that you need. To me, I look at those and I say that they are very similar to those that are there for general purpose financial reports.

And I guess it's a question of within the disclosure regime, what are you looking at those financial statements for? To me, within a regulatory regime, I guess I see them as the base for extracting any further disclosure information that you need, and to me, the comparability, therefore, in relation to the overall general purpose, one from which they are extracted is incredibly important.

CHAIR: That doesn't preclude reaching within whatever may be possible within GAAP or something that narrows the field a little bit?

MS PERRY: No.

CHAIR: For the purposes for which we are trying to use them?

MS PERRY: Certainly extracting in terms of the disclosure some of the information that is within there in terms of identifying those.

CHAIR: Okay.

MR RYAN: Can I follow on a point from that. In terms of accepting GAAP, then one necessarily accepts the auditor's interpretation of materiality, which may not align with the regulator's interpretation of materiality in respect of some areas.

The regulator would be accepting that in the absence of the knowledge of what level of materiality is being applied by auditors. I just wondered if you could comment on that.

MS PERRY: I guess the first thing I'd say is I'd actually see that as a different question than GAAP.

I mean, the auditor's aspect is one that needs to be considered separately. I mean, the GAAP versus what should go into the accounts is different than how they should be audited. I think, and I must admit I didn't focus on what you were suggesting in relation to audit, but my understanding was you would normally say, "Follow the auditing standards," which basically do say look at materiality in terms of the importance of what is there to the readers of those financial statements. I mean, that in essence is how an auditor would look at those.

I mean, whether or not you wanted to get something to more detail, I guess is a separate question.

I would find it difficult, I mean, as I say, I haven't really thought about it to go into a greater deal of materiality. The level of materiality on the regulatory accounts now is the same as it would be on a GAAP set of accounts.

MR ALSOP: It is also a separate issue to GAAP in the sense that the Commission could do its own re-audit or assessment, call it what you will, whether it's that method or another method, as it did on the ODV recalibration audit.

MR RYAN: Just in response to that, I would note the Commission has indicated the materiality in respect of the valuations at 3% which I don't think would be a normal level of materiality.

MS PERRY: No, it wouldn't.

MR MURASHEV: I think it's also an important distinction to make with the asset valuation being used for the purposes of disclosure where I think the primary objective is being able to compare businesses and making sure that it is consistent, as opposed to should the Commission start

considering asset valuation in the context of a control investigation where you may want to go into substantially more detail and have some of those more detailed arguments. We just don't think that you necessarily want to start having those arguments and getting into that level of detail just for the purpose of comparing 28 lines businesses in a disclosure regime.

MR MLADENOVIC: Can I add to the discussion, Joanna. To what extent is creative accounting an issue in practice, notwithstanding GAAP? I am particularly interested in your experience as a professional auditor as to the extent that clients push the boundaries with GAAP and your response to any such behaviour?

MS PERRY: I have been auditing for some - as a partner for some 15 years and it would be fair to say that we have been through periods in New Zealand in terms of creative accounting.

I believe that where we are moving with the standards now, and certainly with New Zealand moving to the international financial reporting standards and the fact that effectively Europe, Australia and New Zealand will be following those, and the interpretations and the consistency of following those standards, and what has happened in the US in particular, so a whole load of things, means that far, far more now companies and auditors are looking, you know, very carefully to ensure that they are being complied with. And the Standards are, I won't say they are more rigid, they are not more broad based, because they are still principles-based in terms of the international ones, but I would say creative accounting, as I think you're describing it, is not something quite honestly that does happen these days.

My experience as an auditor would be that companies and certainly board of directors are very, very, you know,

careful about what are the accounting policies they're following and do they comply with the Standards.

As an auditor, I am usually asked that question by an Audit Committee and in terms of what choices did they have in terms of accounting policies and, you know, which one did they choose? Did they choose the one that was least acceptable?

MR MLADENOVIC: Thank you.

MR RYAN: Just picking up on that point as well. I recall an earlier comment that Vector couldn't, for the life of it, see the difference between sign off by the CEO and directors. I mean, you've made the point there that the directors ensure that the proper policies are being applied. Of course, directors are bound by the legal requirements under the Companies Act to act in the best interests of the companies, unlike the CEO.

For that reason, the certification by directors would have greater attestation value, and for the Commission having that sign off would ensure that matters have in fact come to the attention of those that are ultimately responsible for the governance of the company.

So, I just wondered if you could revisit that comment again in light of those points that I've just made.

MR ALSOP: As it came out today, straight up honest, I felt it was something we hadn't thought hard enough about before we put the submission to the Commission including today's. So, take the comment at face value. It is a good point that you make and we will cover it off in our cross-submission and may come to a different view.

MS PERRY: I am not saying in any way, shape or form that the CEO and CFO do not take responsibility for it. What I am saying is when it does come to the directors in terms of their responsibilities, they need to be very certain of themselves. I am not certainly saying it isn't the case

at the lower level.

MR ALSOP: It might be a useful distinction, what does need to go to the director level versus the CEO level, and come back to the pipelines inquiry where section 70E requests were directed to the CEO, no statutory requirement, that information fed into our regulatory assessment that's being used as a basis to recommend control. So, I just make the distinction between what goes this high and what goes that high (indicates).

MR RYAN: We would appreciate an indication as to what information should go to the directors and what should go elsewhere.

MR ALSOP: Sure.

MR SELL: This is not to setup a shoot-out between the accounting firms, but if you've read the PWC submission, we were quite interested that they were suggesting there was very little need to actually provide the regulatory information in the form of regulatory financial statements.

Maybe it would be useful if you could pick that up in your cross-submission because we would value your input on that.

MR ALSOP: No problem.

DR GUNN: I've got two, perhaps three questions. We will see how the first ones go.

I feel there's a little bit of a catch 22 in the facilitative approach that you're suggesting in terms of the Commission signalling areas it considers there might be problems in the industry and we should do a reasonable level of analysis first before we go to the public and say there's a problem.

The regulator always travels with a problem of asymmetric information and unless we have the information it would be difficult for us to do the analysis to put

forward what the problem is.

I'll give you an example. An issue that Vector has come with is the issue of embedded sub-networks and concerns about that really not being a good deal for consumers.

It seems that that's on the face of it, which originally was suggested by Vector, we perhaps modify the thresholds to take account of that concern, that that really is an area that could be handled much more less intrusively potentially through information disclosure.

Nevertheless, the issue of sub-networks and sub-network competition on sub-division level is really a much smaller issue in some ways than say the concerns regarding non-contiguous larger networks.

I was interested not to see any reference in the submission on embedded sub-networks and wondered if it's no longer a concern to Vector.

MR ALSOP: I can assure you it is an ongoing issue. Those are helpful remarks and a lot of substance to them.

I guess the response I would make on the fly and we'll take up the challenge more on the cross-submission, but I guess it's about the balance between the two. I mean, sort of, how much information is enough to do the sorts of analysis that you are referring to?

I guess a lot of the needs assessment, from our perspective, came back to problems being drawn to the Commission's attention, is there a pattern of complaints to the Electricity Complaints Commission or generators we work closely with? Some of those are anecdotal, and the challenge you're saying to Vector is, if you want us to robustly analyse problems before we go to the industry and say this is a potential issue, that that could be quite information intensive.

DR GUNN: It does relate on the issue of thresholds versus

information disclosure. Here Vector as a user of the information potentially itself saying that this is something that could potentially be done less intrusively through information disclosure than through thresholds. It seems that does suggest there is a wider potential role for information disclosure threshold.

MR MURASHEV: The other issue here is to look at the tools to give the information and does the Commission need the information to be publicly disclosed and can it go? And having found there is a problem, there's nothing stopping the Commission going out into the public domain and saying, "We think there is a problem here."

It doesn't necessarily disclose all of the underlying information.

CHAIR: Can you put your mute on on the other end.

MR VAN BRINK: Sorry, about that, we just lost sound for a second.

CHAIR: Can you put the mute on your's? Thank you.

MR MURASHEV: So, once again, the balance is between how much information you let out into the public domain.

The argument is when you have information disclosed about sub-networks and potential issues, there will be pressure from the public if they see there is an issue there.

What we are saying is the Commission is probably a better place to do that work on the information that they gather and then decide whether there is an issue, and if they think it is an issue then they can go to the public, rather than having that information out there in the first instance even though there might be a problem.

MR ALSOP: Maybe an analogy to help, the general market observation work that the Commission does through Part 2 of the Commerce Act in terms of allegations of anti-competitive conduct where the Commission doesn't

necessarily have a history of information disclosure and a wide variety of industries to rely on, instead of investigators doing some prima facie assessment of does this smell like an issue, talk to some people, gather some data through public domain or through asking people.

Layer on that Anton's point, that the Commission can apply at any time and at any point in the Part 4A regime, possibly also an argument the Commission could use 70E, we are not quite sure whether the definitive status of that - that's a strictly information gathering approach, as distinct from a disclosure approach with the potential downside of the disclosure that we've given you adnauseum through the submission.

DR GUNN: That particular sub-networks issue really comes to the heart of Vector's submission that the focus should be on price and quality, sub-networks is a sort of example like that. I think that it really shows to what extent can disclosure be meaningful for consumers on a completely aggregate level right across to non-contiguous networks.

There's been a lot of references in the submission to Parliament's intent and I think if you go back to where Part 4A came from and look at the Ministerial Inquiry, a lot of the recommendations came from KPMG's report looking at performance indicators.

KPMG looked at the issue of disaggregation and the recommendation really was that in terms of customer outcomes price and quality, disaggregation, not down necessarily to the enth degree, but in terms of different geographical areas, CBD versus rural and remote rural, is something that can be useful. That does seem at odds with Vector's suggestion that we should focus entirely on the aggregate.

We certainly would be interested in seeing Vector's comments further.

MR ALSOP: Just a couple of quick comments if I have time.

CHAIR: We are going to take three minutes.

MR ALSOP: While the threshold is set at an aggregate level, my understanding is Vector's prices through all different variables are available in its compliance statement. So, what's the incremental effect from further disclosure and granularity on price levels at sub-network or on another basis.

Another comment I would make, and it may be one for us to further think about in the subdivision issue as well, maybe there just are some imperfections in the regime, it's not going to achieve everything perfectly, there's market imperfections and regulatory imperfections. Do we want the regime to chase the IUTI detail or do we want to what we say is consistent with Parliament's intent, to stay at that directional trend based level to move the large pack in the right direction?

MR VAN BRINK: It would be good if we could put more detail to you in writing because it is a complex issue. The sort of thing that comes to mind in relation to the sub-networks are the ability of consumers to really identify what's happening. Even in a shopping mall consumers don't know whether what they're paying in their electricity price contains a fair lines charge for the local network as well as the incumbent distributor's networks. Electricity prices are bundled and it's sometimes quite hard for customers to identify what's going on.

So, there are a number of complex issues which I would prefer that we put back to you in writing in more detail. Also in relation to non-contiguous networks, what is a definition of those networks, we would be keen to put something more full to you for discussion.

CHAIR: I think that is a good suggestion and we are well and truly out of time for this session. So, unless someone

has a must ask question, I'm going to close this session.
(No questions).

We have asked that all submitters come back to us by the 5th of April with any responses to issues that have come up during the hearings, and of course that's the same date as cross-submissions.

So, I see everyone nodding their heads, so we will take that as an agreement to come back by the 5th of April.

I will give you the last opportunity to say anything further you'd like to say to us before we move to the next session. Is there -

MR VAN BRINK: We do appreciate the ability to talk through these issues with you. I think it's been good today that we've identified some areas where there have been, I think, quite notable differences in our stance and also we appreciate some of the clarification we have received in a couple of areas.

We would be keen to come back to you, as I said before, in terms of our cross-submission and provide some further detail around what we believe to be quite a strong position that we would like to push through to you for consideration, and also reflect our stance in light of what you've told us through the questions. I really appreciate the ability to be able to spend some time with you on this. Thanks very much.

CHAIR: Thank you for that. I think, you know, we have had quite a good discussion throughout the hearings on the issue of the purpose of disclosure and I think it is important because this is a long process we're going to go through on this. We will work through in workshops a lot of the detail but we do need to have a fairly common understanding of what purpose we need information disclosure.

So, I think the discussion has been quite useful and we will look forward to the further information that you will provide.

So, I would now like to thank Vector for both their written submissions and their summary today, as well as the engagement of the questions.

We are grateful, as always, to you for both your own submissions and access to your experts. So, thank you once again.

Now, we will just take two minutes to switch now to the last presentation of the day. So, I will ask that people do not leave the room because I really just want it to be a quick changeover, please, and we will be using the video conference, I understand, for the last session as well.

PRESENTATION ON BEHALF OF JARDINE LLOYD THOMPSON

MR CRAWFORD: Good afternoon.

CHAIR: Good afternoon. Thank you for joining us. We will just reconvene this session now and I would like to welcome Jardine Lloyd Thompson, who I know that you've put in a written submission.

The process that we are following is we will allow you an opportunity to give us a brief summary of your submission, which we have all read, and then we will have some questions at the end.

So, if you would please introduce yourselves for the record. I need you to state your name and the company for the purposes of the record and then you can begin your submission summary when you are ready, thank you.

MR CRAWFORD: Thank you very much. My name is David Crawford. I represent Jardine Lloyd Thompson, who are Insurance Brokers.

A question probably before we start, is a colleague of mine, Paul Carpenter, in the room?

CHAIR: He is here sitting to my left. He can see you, even though you can't see him.

MR CRAWFORD: Thank you.

MR CARPENTER: My name is Paul Carpenter of Jardine Lloyd Thompson.

MR CRAWFORD: Okay, thank you very much. Our submission related to only three paragraphs of the information disclosure regime review which was relating to insurance, paragraphs 207-209.

What I have done for the Commission is prepared a short slide presentation, which is in paper format now, which hopefully you have in front of you. Can you confirm that you have that?

CHAIR: Yes, it's been distributed, thank you.

MR CRAWFORD: Fantastic. The purpose of us presenting, in addition to our submission, is to clarify some issues relating to insurance versus self insurance, and really to answer any questions the Commission has regarding pricing of and availability of cover for lines companies in New Zealand.

If I may start just by presenting a little bit of information about the insurance market. Myself, I have been in the industry for some 30 years, it seems a long time. Mr Carpenter is a little bit younger than I am but similar levels of experience both in New Zealand and overseas.

The insurance market in New Zealand really is very, very small in global terms. There are no longer any New Zealand owned insurance companies, they are primarily Australian and American. We are very, very much a small player and therefore dominated by what happens overseas.

We are heavily influenced by global re-insurers which generally react very strongly to things like major events that happen around the world, and a prime example is the terrorism attack on September 11, which caused the insurance industry to make a radical change to the way it operates.

Although I don't want to do a discourse on insurance, the insurance industry is cyclical in nature but in recent years the insurance market has become more restrictive, businesses have seen higher prices, higher self-retention and often accompanied by a reduction in the amount and availability of cover.

The example is the terrorism attack of September 11th, where the following year almost globally throughout the world there was a blanket exclusion for terrorism on all material damage to property insurance policies.

So, that really is a bit of background on the insurance market.

The next slide talks specifically about electricity lines companies and the fact that today certain risks are no longer insurable. Terrorism is a classic one I've just talked about. Governments overseas, particularly the UK, Australia and the USA, have provided compulsory funds backed by legislation.

The New Zealand Government has chosen not to do anything and let the market, I guess, regulate itself.

There is another risk which is uninsurable, which is loss or damage to network assets, and by "network assets" we mean the lines and cables that the lines companies own, which historically has had bad experience, primarily in the Northern Hemisphere relating to hurricanes and typhoons. It's filtered down to New Zealand and as re-insurers overseas stopped providing cover, insurers in New Zealand did the same thing, and insurance cover now for lines companies distribution assets are generally not available, or if they are available, then at extortionate terms.

The key point here is the risk exposure is not new, but the ability to transfer the risk to the insurance market is no longer available to the lines companies.

Therefore, lines companies in New Zealand now have a risk exposure for a large part of their assets that they can not purchase insurance cover for economically.

On the next slide I've just put some brief numbers down about what this actually means, and I've used ODV numbers, primarily because it's readily available.

But the numbers are pretty self-explanatory. Nearly 90% by ODV is currently self-insured by the lines companies in New Zealand.

The remaining 10% primarily relates to zone

sub-station FX.

The RC is replacement cost, because in the insurance industry most property insurance is related to replacement value, not depreciated value, and it's our estimate that nearly \$10 billion of lines company assets are currently self-insured.

The next slide relates to the idea that we do - New Zealand is not an undangerous place to live. Global warming is becoming a reality and scientific evidence is available that links - there is a link between climate change and the increasing rate of natural catastrophe that we are seeing around the world. Not only things like the tsunami last year but the fact that last year four hurricanes came through Florida in a two week period, never been seen before. A number of typhoons in Japan. I think last year, 2004, was the costliest year for natural disasters ever, with over US\$40 billion in losses.

So, the risk landscape is changing. New Zealand is not immune and lines companies assets are exposed. New Zealand, as we all know, is both earthquake and volcanic and all sorts of other things exposed. Our research shows that historical records are, no real prediction of the future.

In other words, rare events are becoming more frequent.

If I can turn now to the question of self-insurance, which is on the next line.

Companies often use self-insurance as an ability to absorb losses and it's normally a factor of the size and ability (next slide) to absorb financial loss in a given year.

An example is British Petroleum, which basically self-insure everything because they have the size and spread of risk which allows them to do so, and they have

data to support the fact that the saving in annual self-insurance costs over time pays for their losses.

Many companies in New Zealand choose to self-insure, and the primary example is by taking a deductible of whatever size and absorb the losses under that.

Self-insurance in that case is very cost effective. In cases of extreme events, there is no cost to the business until you have a loss, but it does provide an extortion in terms of risk modelling particularly relating to large losses.

In the case of network asset, the owners carry the risk and in this case it's been voluntary in nature.

It is not a voluntary decision by the owners of the assets. It's involuntary because basically there is no other option available to them or there has been no other option.

Restoration costs must be funded in some way, either by working capital, borrowings in the case of those where working capital is not sufficient, or, in extreme cases, from the shareholders.

Often, in our experience, when events of this nature happen there's limited access to additional capital because everyone is looking for it at the same time, therefore it's less available and it's more expensive.

Turning to the consequences of self-insurance, and I am cantering through this, given the time of the day and what have you, the restoration needs to be funded in the event that there was an earthquake or a volcanic eruption or some such event in New Zealand. Restoration would have to be done by the individual lines business.

In many cases it could bring forward re-investment in the network that was not planned, and there's the question mark on the cost of borrowing to restore the network at the particular time of the event.

There's the natural effect on the customer and the community. Many customers are also owners of the networks through trusts or through the councils, and adverse costs on the lines companies could also affect the ability to either do distributions to the consumers via the trust, or many companies give consumers, I don't know what the exact term is, but effectively a free month or two of their electricity bill, and that could be effected in the event of a loss.

And lastly, there is obviously the potential for breach and the need to recover costs from customers post-event because the restoration would have to be funded from somewhere and those costs should, in an ordinary course of events, be recoverable through the ability to raise prices over time.

On the next page I have put forward three basic options of what we believe is available to a lines industry in New Zealand. Basically, it's to do nothing, which is in governance and best practice risk management is not the ideal scenario. It's a bit like putting your head in the sand and hoping it doesn't happen, or accept that there is a potential for a breach and rely on your good selves post-breach to allow price rises to recover the costs of restoration.

The second option is some sort of captive insurer, given the insurance market does not want to accept this sort of risk and for the foreseeable future there's no sign of that changing. This is difficult for all but the largest companies.

I know Vector has looked at this but it's not in the business of insurance and it is a costly exercise.

Transpower is the only company in the lines industry that I know has a captive insurer and that captive insurer does fund part of its network risk.

The final option is something that we've been working with the lines industry for a couple of years, and that is a mutual risk fund where lines companies come together to pull their risk, very much like insurance, and very much like what local Government have done for their infrastructural assets and liability risks.

If I may talk a little bit about the ENA - what we've termed the "ENA catastrophe programme". We have had some discussion with the Commerce Commission over the past year regarding the potential of putting together a mutual fund for the industry and looking at the feasibility of this to primarily cover the uninsured assets that the industry company have.

It's an industry-wide solution which would over time bring stability to lines companies by allowing them to ensure or pass the risk of events happening to their assets for a visible cost that is essentially done on the same premise of insurance, size of assets and risk exposure. It removes the price volatility in event of a major loss by providing funding post-loss. And for the entire industry in New Zealand, it works out at something like about a \$3 million price tag per year, which equates to about \$1.70 per customer or per connection, I should say.

The last slide is just a number of things I have put down. Apart from good governance and risk management, which in risk management if you cannot handle the risk yourself you look for ways of transferring it, is why would lines industries do this?

It provides a mechanism for transferring the risk and it is done in a way that is lower cost, and if everyone did it on their own it removes the potential for breach post-event.

It brings certainty and visibility to an area which,

as you well know from experiences overseas, self-insurance is very hard to price because there is no, in our words, there is no risk formula for doing individual companies that I am aware of around the world, although Australia has allowed some things, I understand, in recent times.

Our experience with local Government is it provides a robust long-term solution. It's proven to work.

However, it does introduce a new cost to the industry, which previously was included in insurance, but of recent years that cost has not been there because there has been no market to insure.

Our discussions with the Commerce Commission to date have been around allowing this new initiative for the lines industry in the past through cost.

Madam Chairman, that really is a canter through insurance and our submission. I appreciate I was talking at a fast rate but I hope I have covered most of the ground and am happy to take questions.

Paul Carpenter, my colleague who sits alongside you, manages one such fund for local Government and that's the reason why he is here.

So, the floor is open to you.

CHAIR: Thank you for that summary.

I want to come back to the questions that the Commission put on page 49 of the discussion paper. I do recall that we've had discussions about whether the costs should be allowed as a pass through, but leaving that issue to one side, we raise two issues in paragraph 209, one was on materiality of the issue and you've given us some information on that.

The second one really is about practical ways to achieve comparability between businesses that self-insure and those that don't, because that's what's at issue for us in this hearing.

Your submission suggests there isn't anyone who's able to contract with an insurer, so it suggests that the comparability issue wasn't there, though I thought I had recalled that some of the companies did have at least partial insurance and that's what they told us at the last hearing.

So, I think we still do, unless I'm wrong about that, we still have some companies that self-insure and some that have a contract with an insurer for at least some of their insurance needs.

I guess the question that leaves me with is in terms of what we're trying to do with the disclosure regime, where does that leave us in terms of achieving comparability between the businesses and how much difference does it make for our purposes?

I understand it may be material, these may mean material dollars to companies, but for our purposes, in terms of our need to compare performance between companies, how much difference does it make?

MR CRAWFORD: Yes, I understand. It is true that insurance, until recent times - there are two points.

One is, yes, companies do insure part of their networks under a traditional insurance model but it is primarily around zoned sub-stations.

Insurance cover has been available until, as far as we can ascertain and having talked to all lines companies over the last few months, until as late as 2003/2004 some companies have been able to buy some insurance cover.

My understanding is in 2005 that has ceased and there is now no availability of cover for lines, cables, poles, pole mounded transformers, distribution transformers, that sort of thing, which make up pretty well most of the assets of the lines companies.

So, I think you are right, Madam Chairman, that there

was a time when there was an inconsistency between self-insurance and insurance. Companies can buy limited insurance cover but the cost is prohibitive, that it does not make economic sense in the traditional sense.

So, as we come to 2005, I think you'll find that now in New Zealand none of the lines businesses have insurance cover for their distribution assets.

Therefore, the ability to differentiate between the performance of each lines company is much easier because no-one has it.

CHAIRMAN: And I guess that's really where I was coming to. For the purposes of the matter before us today, if you're correct about them not being able to insure, there is not a comparability problem.

Whether we should allow costs pass through of proposals such as the one you presented to us, and we're talking to the industry about it, is a separate issue to that which we are covering today, though it's good to get an update on what's being discussed, but it is a separate issue to today's issue.

In terms of information disclosure, or asset valuation choice, I just wonder if, is there something in those particular subject matters, the ones that we are deciding within this conference, is there anything additional that you would like to draw to our attention?

MR CRAWFORD: In terms of disclosure, no, I don't believe so. I think the whole - my understanding of the inclusion of the clauses in the disclosure review were based on a submission we made to your good selves last year, and that came around, is this a material issue or not, and how does it vary between the businesses, lines companies in New Zealand?, our research has shown that there was some variability but that has gone. The only thing that we are aware of is there are some businesses in New Zealand who

have put aside funds but I am not sure that that has any materiality in terms of the pricing regime.

The treatment of insurance as a business risk, I think for the purpose of this conference and the review of the information disclosure, insurance generally is not a material cost to lines businesses. However, the cost of a catastrophe event to the network is.

CHAIR: Yes.

MR CRAWFORD: Therefore, I think the issue is primarily one about, it's an even playing field at the moment but post an event, there would be issues to be dealt with for obvious breaches and a need to look at pricing going forward.

CHAIR: Yes.

MR CRAWFORD: And the fact that because there is no insurance available, is the cost of self-insurance factored into the disclosure regime and pricing.

CHAIR: Okay. I just want to check with my colleagues if they have any further questions.

MS BATES: No, no questions.

MR HEMMINGWAY: It's very straightforward.

CHAIR: Paul and staff?

MR SELL: Can I just clarify, you're saying, presumably based on some form of actual art study, the total cost is only \$3 million out of \$5 billion worth of assets, so we're looking at 0.06% of the ODV? I want to make sure we all go away with the right picture in our minds of the materiality of this.

MR CRAWFORD: Yes, yes. No, the way that the mutual fund that we're talking about is structured, it provides a level of cover, not 100% of cover because that would be too expensive, but it provides a level of cover to cover most foreseeable events. And the cost of that would present the industry with an annual cost of about \$3 million and

that would allow the industry over time, much as local Government has done, to build up funds that would be available in the event of a natural disaster.

MR SELL: Thanks.

CHAIR: Any further questions from staff? (No questions).

I think that completes the questions from the Commission but I will give you a final opportunity to make any further comment, and, Paul, if you have anything you would like to add you are most welcome to do so.

MR CARPENTER: The only comment that I perhaps have to make is with regards to the different nature or the descriptions of the companies, and that is the comparative ability to recover post-loss and this fund presents an opportunity to the industry to remove that disparity between the companies post-significant natural catastrophe.

CHAIR: Yes. I mean, I understand that, but that is a matter for the companies, rather than for the Commission, I suspect.

Okay. I now then will thank you for your written submission and for appearing before us and providing us with the summary and taking questions. While I have no doubt these are important issues for the companies, in that sense you have a keen interest to know we are addressing some uncertainty and risk you are carrying in that area, so thank you very much for your time.

Before adjourning for the day I will note that we are meeting at 9.30 on Monday morning and we will be down in Wanaka on the Ground Floor. We will be hearing from Marlborough Lines, Orion, The Lines Company and Powerco, and that will complete the proceedings on Monday.

So, I thank you all once again and wish you all a good weekend. Thank you very much.

MR CRAWFORD: Thank you very much.

Conference adjourned at 4.50 p.m.