

**Cross submission following the  
Commerce Commission Conference on  
the Review of Information Disclosure  
Requirements**

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## **Executive summary**

This cross-submission is from the Electricity Networks Association. It considers a number of the issues discussed at the recent Commerce Commission conference on the Review of Electricity Information Disclosure Regime. Recommendations for each issue are listed below.

### ***Uses of disclosed information***

- Focus the information disclosure requirements on the information required to implement the thresholds regime.
- Clarify the dimensions of performance the Commission intends to consider when resetting thresholds in order to determine what information needs to be disclosed to undertake this task.
- If the Commission wishes to require information additional to that needed to implement the thresholds regime it should clarify its intended audience and provide practical examples as to how it is expected to be useful, in order to avoid treating such additional information as a free good.

### ***Valuation method and the need for a Commission Guide***

- Use ODV as the valuation method for information disclosures, provided it is implemented properly, and maintained consistently through time.
- The Commission should issue a Guide as to how it intends to implement and maintain the electricity targeted control regime, and in that Guide cover the approach it intends to take to re-setting thresholds and to maintaining the currency of the asset values in the ODV Handbook.

### ***Use of GAAP and the need for reconciliations***

- Disclosure information should be required to be GAAP compliant.
- Any restrictions to GAAP should be minimised. If any restrictions are required, the Commission should consult on the detail as to how the restrictions are to be framed in order to test that the approach minimises additional compliance costs.
- Reconciliations between regulatory and statutory accounts are unnecessary. However, if the Commission decides to require reconciliations, they should be confidential to protect commercially sensitive information.

### ***Definition of the reporting entity***

- Define the reporting entity for disclosure information consistently with the scope of disclosures as set out in section 57T (2) (a), which is "... concerning their

business as a line owner or as an electricity distributor”, and not require information from any other businesses the same legal entity may operate.

- Continue to use ACAM for allocating costs between the reporting entity and any other businesses owned by the same legal entity.

### *Treatment of income tax*

- Tax depreciation should be calculated using the same asset values as used for reporting the asset base of the business, and GAAP should be followed to calculate tax expense.

### *Productivity and service performance reporting*

- The Commission should ensure in the development of productivity and service performance measures that business conditions not under electricity distributors’ control are taken into account. Adherence to changing ‘best practice’ standards should be encouraged (recognising the tendencies in the regime for promoting rigidities and status quo behaviour).
- The Commission should use workshop forums, as it has indicated, to test possible productivity and service performance measures with interested parties. This process could commence with an invitation to lines businesses to propose a set of productivity and service performance measures.
- Where there is a trade-off with comparability between historical and future disclosures, versus improving the comparability of data between businesses going forward, the Commission should opt for improving comparability between businesses going forward.
- The Commission should make use of emerging GAAP in service performance reporting, which reflects service performance reporting practice in the local and central-government sectors.

### *Disaggregated information*

- If the Commission wishes to have service performance information provided on a geographically disaggregated basis, it should test any proposed approach in a workshop forum to ensure the approach is consistent with the manner in which the relevant information is gathered and stored.
- The Commission’s concern related to cross-subsidies does not warrant further attention in the context of the disclosure review. There is an absence of evidence that such cross-subsidies exist (other than those that might arise due to regulatory constraints and the Government Policy Statement requirement for changes to rural distribution charges to be in line with urban ones), and the compliance costs of providing meaningful information to test for cross-subsidies are high.

***Prospective information***

- Prospective information should not be required to be disclosed, other than what is already required in asset management plans.

***Cost pass-through for insurance costs***

- In relation to current thresholds, the Commission should allow the cost of insurance of network assets, which has to date been under-reported due to lines businesses self-insuring, to be a “pass-through cost” under the thresholds.
- Similarly, other new risk management costs (such as IT protection) that emerge as tangible requirements due to changing conditions should be recognised as “pass-through costs” where companies comply with new, recognised, industry practices.

## Introduction

1. This cross-submission, from the Electricity Networks Association (ENA), considers a number of the issues discussed at the recent Commerce Commission conference on the Review of Electricity Information Disclosure Regime and recommends how best to take each issue forward. The issues covered are:
  - Uses of disclosed information
  - Valuation method and the need for a Commission Guide
  - Use of GAAP and the need for reconciliations
  - Definition of the reporting entity
  - Treatment of income tax
  - Productivity and service performance reporting
  - Disaggregated information
  - Prospective information
  - Cost pass-through for insurance costs

## Uses of disclosed information

2. The Commission stated in its Review of the Information Disclosure Regime Discussion Paper (Review Paper) that it expected disclosed information could be used for:<sup>1</sup>
  1. Setting thresholds.
  2. Assessing compliance against thresholds.
  3. The initial stage of a post-breach inquiry.
  4. Informing a “wide range of people” about the operation and behaviour of lines businesses.
3. The ENA considers the focus of the disclosure requirements should be on implementing the thresholds regime (i.e. on points 1-3 above), as it forms the primary constraint on lines business behaviour. To that end the ENA suggests the Commission clarify the dimensions of performance it intends to consider when resetting thresholds, in order to inform the Review as to the relevant performance information that would need to be disclosed.
4. It is much less clear what information would be useful in informing “a wide range of people”, and whether there would be net benefits in doing so. It is important the Commission does not treat information as a free good (as it is not) and require additional information to be disclosed in the hope that it may be useful. Where the

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<sup>1</sup> See paragraphs 148 and 149 of the Review Paper.

Commission considers information should be disclosed additional to that required to implement the thresholds regime, the ENA considers the Commission should clarify the intended audience for that information and provide practical examples as to how it may be used.

## Recommendations

- Focus the information disclosure requirements on the information required to implement the thresholds regime.
- Clarify the dimensions of performance the Commission intends to consider when resetting thresholds in order to determine what information needs to be disclosed to undertake this task.
- If the Commission wishes to require information additional to that needed to implement the thresholds regime it should clarify its intended audience and provide practical examples as to how it is expected to be useful, in order to avoid treating such additional information as a free good.

## Valuation method and the need for a Commission Guide

5. The submissions and submitters at the conference provided strong support for the use of ODV as the valuation basis for electricity distribution businesses, with no support for the Indexed Historic Cost Method (other than by Transpower for transmission).
6. The ENA prefers ODV as the valuation method for regulatory disclosures, subject to it being implemented properly, and maintained consistently through time. This implementation should include, in the ENA's view, the Commission committing to the regular and transparent updating of asset values (assuming a Handbook is retained) to ensure they reflect the prices that lines businesses face in practice, and clarifying the manner in which the Commission intends to use asset valuations (and other disclosed information) in resetting thresholds.
7. Commissioners questioned their ability to provide guidance as to the manner in which the Commission would approach its tasks in the future. However, the Commission has for many years provided formal guidance as to how it will undertake other aspects of its responsibilities. Examples include the following Commission documents:
  - Merger and Acquisition Guidelines, the latest version of which applied from January 2004.
  - Regulation of Electricity Lines Businesses, Targeted Control Regime, Assessment and Inquiry Guidelines, 19 October 2004.
  - A Guide to the Role of the Commerce Commission in Making Access Determinations under the Telecommunications Act, 28 May 2002.

8. The purpose of these documents is to provide greater certainty and clarity as to the approach the Commission intends to take when undertaking the tasks covered in each of the Guides. The approach the Commission intends to take when implementing the targeted control regime for electricity line businesses is similar in nature to the topics covered in the other Guides. Such a Guide could, amongst many other things, cover the approach it intends to use to reset thresholds, and the procedures it intends to use to maintain the currency of the ODV Handbook.
9. The targeted control regime has now been in place for almost four years. The ENA considers it important and timely that the Commission set out how it intends to maintain the regime through time. Such a move is particularly important in relation to the use of ODV, as it is a robust approach only insofar that it is implemented consistently and properly through time. The ENA's members invest hundreds of millions of dollars each year in long-life and sunk assets, and it is critical that the mechanisms for constraining the pricing of services delivered by those assets can be relied upon.

## **Recommendations**

- Use ODV as the valuation method for information disclosures, provided it is implemented properly, and maintained consistently through time.
- The Commission should issue a Guide as to how it intends to implement and maintain the electricity targeted control regime, and in that Guide cover the approach it intends to take to re-setting thresholds and to maintaining the currency of the asset values in the ODV Handbook.

## **Use of GAAP and the need for reconciliations**

10. Commissioners at the conference appeared inclined to require Generally Accepted Accounting Practice (GAAP) compliance for disclosures, but with possible additional restrictions in certain circumstances (e.g. restricting the valuation methods that could be used). The ENA supports the use of GAAP, and suggests the Commission impose additional reporting restrictions only in cases where there is a clear net benefit from doing so. If additional reporting restrictions are proposed, the ENA requests the Commission consult on the detailed manner in which they are framed in order to obtain input as to how the intended outcome could be achieved with minimum additional compliance costs.
11. From the discussion at the conference of the possible need for reconciliations between a business' regulatory and statutory accounts, it appears the primary reason for such a reconciliation would be to add additional comfort as to the robustness of the disclosed information. However, if the regulatory accounts are prepared and audited according to GAAP, then the compilation method of the two reports would be the same and reconciliation would appear to add little.
12. Reconciliations are unlikely to be simple. A number of lines businesses have financial years that differ from the current regulatory reporting year ending 31 March. Any restrictions to GAAP that apply to the regulatory accounts would further complicate reconciliations (e.g. if the valuation methods differ).

13. The ENA considers that, provided the regulatory accounts are prepared and audited consistent with GAAP, reconciliations between them and the statutory accounts are unnecessary. However, if the Commission decides that reconciliations are required, the ENA considers it important that they are provided on a confidential basis only, as they are likely to contain commercially confidential information.

## Recommendations

- Disclosure information should be required to be GAAP compliant.
- Any restrictions to GAAP should be minimised. If any restrictions are required, the Commission should consult on the detail as to how the restrictions are to be framed in order to test that the approach minimises additional compliance costs.
- Reconciliations between regulatory and statutory accounts are unnecessary. However, if the Commission decides to require reconciliations, they should be confidential to protect commercially sensitive information.

## Definition of the reporting entity

14. Commissioners indicated in the conference possible interest in acquiring information on businesses other than the electricity distribution business. From a reporting perspective such information would raise issues as to whether the reporting entity had been properly defined.
15. The reporting entity for information disclosure is set out in section 57T (2) (a) as:  
“...concerning their business as a line owner or as an electricity distributor:”
16. The terms “line owner” and “electricity distributor” are defined respectively as (Electricity Act 1992, section 2):  
“line owners means a person that owns works that are used or intended to be used for the conveyance of electricity”  
“electricity distributor means a person who supplies line function services to any other person or persons”
17. Thus it is clear that the information disclosure requirements relate to the electricity distribution service, and it follows that the reporting entity for disclosure purposes should be defined as this aspect of the electricity distributor’s business only. It is not clear why the Commission would require information from other businesses that may be operated by the same legal entity. Furthermore, the Commission would appear to not have the powers under section 57 T to require such wider disclosures.
18. The ENA considers the reporting entity for disclosure purposes should be defined consistently with the scope of the disclosures as set out in section 57T (2) (a).
19. A second issue related to the reporting entity is determining how to report costs that are common to the electricity distribution business and other businesses operated by the same entity. To date this issue has been addressed with the application of the Avoidable Cost Allocation methodology (ACAM), which

ensures that cross-subsidies (as defined in economic terms) do not arise between the two businesses.

20. Commissioners appear to be concerned that ACAM may allow businesses to achieve economies of scope between an electricity distribution business and other businesses, and not reflect those economies in its reported costs. It is not clear what the economic problem of such an outcome is, or what superior basis of cost allocation the Commission has in mind. In the absence of identifying an economic problem arising from the use of ACAM, or of identifying a cost allocation method that would unambiguously lead to superior economic outcomes, the ENA suggests the Commission retain the use of ACAM.

## Recommendations

- Define the reporting entity for disclosure information consistently with the scope of disclosures as set out in section 57T (2) (a), which is "... concerning their business as a line owner or as an electricity distributor", and not require information from any other businesses the same legal entity may operate.
- Continue to use ACAM for allocating costs between the reporting entity and any other businesses owned by the same legal entity.

## Treatment of income tax

21. Commissioners questioned some submitters as to how income tax should be reported in the disclosed information. The ENA considers there are two principles that provide clarity as to the appropriate treatment of tax, namely:
  - That tax depreciation calculations should be undertaken using the same asset values that are used for determining the reported asset base of the business in disclosures. If the ODV valuation method is used to value the asset base, consistency argues that the same asset values should be used to calculate tax depreciation.
  - That GAAP should be followed in determining how income tax is reported, which leads to the use of the tax expense measure.
22. The Commission appears to be exploring the possibility of having businesses report the cash tax they pay. However, such an approach would be inconsistent with the principle underpinning the ODV valuation method of attempting to construct a view of the capital costs, and related tax implications, that an efficient entrant would face to supply the electricity distribution service. There are a wide range of reasons why firms may pay more or less tax over particular periods which have nothing to do with how efficiently they are being run in an operational sense (e.g. due to tax losses that were generated in other businesses the same legal entity operates, or how acquisition transactions were structured).

## Recommendation

- Tax depreciation should be calculated using the same asset values as used for reporting the asset base of the business, and GAAP should be followed to calculate tax expense.

## Productivity and service performance reporting

23. The Commission indicated in the Review Paper that it has yet to consider productivity and service performance issues in any detail, and signalled that workshops would be convened in the future to address these issues in more detail.<sup>2</sup> These issues did not receive much attention at the conference.
24. The ENA agrees with the proposed use of workshops to test possible productivity and service performance measures and it would be useful to commence this process with an invitation to lines businesses to propose a set of productivity and service performance measures.
25. If productivity measures are to be used to rank firms (e.g. in the process of resetting thresholds), such a ranking is meaningful only if the output measures that are used take into account differing business conditions faced by firms. This is difficult to achieve across electricity distribution businesses as differences in business conditions over which the firm has little or no control, such as average load, consumer density, and terrain and climate can lead to very significant variances in costs to supply a given distribution service.
26. These difficulties are well known and have been described, and in part addressed, in some benchmarking studies of electricity and gas businesses internationally. There is thus a literature that can be referenced on this topic and substantial empirical work has been undertaken locally and internationally on it, much of which has been presented to the Commission over the last three years in the context of developing the initial thresholds and in the Gas Inquiry. The ENA considers the Commission should ensure the findings from this benchmarking material are incorporated into any proposed productivity measures.
27. Similarly, if service performance measures are to be used to compare performance across firms, they need to take into account business conditions that affect the distributor's ability to deliver the particular dimension of service performance. This may, for example, lead to differentiating service performance reporting across differing consumer density groups (e.g. urban versus rural).
28. When developing productivity and service performance measures the Commission is likely to face trade-offs between consistency with historical data versus improving consistency among firms going forward. This is likely to arise where it wishes to make improvements to existing measures to improve clarity or consistency, but in so doing historical data may no longer be directly comparable to future disclosures.

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<sup>2</sup> See paragraphs 310 - 312 of the Review Paper.

29. The ENA considers it more important and useful to the Commission for disclosures going forward to be comparable among businesses, than in maintaining comparability with historical data. Thus is because the threshold-related decisions for which the Commission is likely to use the information will generally relate to performance in periods since the thresholds were reset in 2004, rather than to earlier periods.
30. There is emerging GAAP in relation to service performance reporting, which has been codified by the Institute of Chartered Accountants of New Zealand in the Statement of Concepts, Financial Reporting Standard 2: Presentation of Financial Reports, and in Technical Practice Aid 9: Service Performance Reporting. This material reflects progress in service performance reporting in the local and central government sectors and is likely to provide useful guidance when developing service performance reporting requirements for electricity distributors.

## Recommendations

- The Commission should ensure in the development of productivity and service performance measures that business conditions not under electricity distributors' control are taken into account. Adherence to changing 'best practice' standards should be encouraged (recognising the tendencies in the regime for promoting rigidities and status quo behaviour).
- The Commission should use workshop forums, as it has indicated, to test possible productivity and service performance measures with interested parties. This process could commence with an invitation to lines businesses to propose a set of productivity and service performance measures.
- Where there is a trade-off with comparability between historical and future disclosures, versus improving the comparability of data between businesses going forward, the Commission should opt for improving comparability between businesses going forward.
- The Commission should make use of emerging GAAP in service performance reporting, which reflects service performance reporting practice in the local and central-government sectors.

## Disaggregated information

31. Commissioners questioned a number of submitters as to the desirability and practicality of providing information on a disaggregated basis. Disaggregated information in this case appears to mean disaggregation into geographical areas, as opposed to disaggregation in terms of, for example, different types of consumers.
32. It appears Commissioners are interested in possible disaggregation of information for three reasons:
  - For the Commission to identify the variability in service performance within networks as well as across them.

- For consumers to be able to identify service performance related to their particular network area.
  - For the Commission and consumers to identify any cross-subsidies between network areas.
33. The ENA considers that the provision of disaggregated information with respect to service performance (i.e. to address the first two reasons) is likely to be reasonably straightforward to provide, and be meaningful, as long as the network areas are defined in a manner that is consistent with the manner in which the service performance information is collected and stored. Defining the details as to how this could be achieved is probably best progressed in a workshop forum.
34. The ENA has reservations on the third point, that is, on the provision of disaggregated information in order to test for cross-subsidies. It appears the Commission's concern is driven by the observation that some lines businesses operate across network regions in which the consumer beneficiaries of their shareholding trusts reside, and regions in which they do not. The concern is this configuration may lead a lines business to price in a manner that cross-subsidises the price of the distribution service in the "owner's" region from prices in other regions.
35. The Commission has yet to define what it means by cross-subsidies, but the usual economic test for a cross-subsidy is where prices are set below incremental cost in one area, and above stand alone cost in another.
36. Lines businesses have commercial incentives not to provide services below cost, so it is questionable whether this issue exists, except due to the operation of regulatory constraints. For example, the requirement in the GPS to keep any changes to rural lines charges in line with urban lines charges, and the gazetted requirements related to the provision of low fixed-tariff options, place constraints on the extent to which lines businesses are able to adjust their prices. To the ENA's knowledge the Commission has not cited examples of perceived cross-subsidies, so at this stage it appears to be a possible problem rather than an actual known one.
37. A robust cross-subsidy test is relatively difficult to undertake. One needs, for example, to define the time period over which cost increments are to be considered, and identify the assets and operating costs incremental to each network region over the given time period, as distinct from common costs. Normal historical accounting processes do not capture information in this way, so the compliance costs to provide this information would be high.
38. The ENA does not consider this perceived cross-subsidy concern warrants pursuing further in the context of the information disclosure review. If the Commission is concerned with cross-subsidies, the ENA suggests it make submissions to Government on the need to relax the regulatory constraints that tend to give rise to them, if and where they exist.

## Recommendations

- If the Commission wishes to have service performance information provided on a geographically disaggregated basis, it should test any proposed approach in a

workshop forum to ensure the approach is consistent with the manner in which the relevant information is gathered and stored.

- The Commission's concern related to cross-subsidies does not warrant further attention in the context of the disclosure review. There is an absence of evidence that such cross-subsidies exist (other than those that might arise due to regulatory constraints and the Government Policy Statement requirement for changes to rural distribution charges to be in line with urban ones), and the compliance costs of providing meaningful information to test for cross-subsidies are high.

## Prospective information

39. In the Review Paper the Commission cites the following two reasons for having prospective information disclosed:<sup>3</sup>
  - That jurisdictions subject to incentive based regulatory control require it.
  - It would enable the Commission to compare ex post revenue and expenditures with projections, in the same way that management and boards compare performance of an entity with its budgets.
40. However, New Zealand does not have incentive based regulation of the kind referred to above, and it is not the Commission's role to replicate the governance role of boards or the role of management. No additional reasons emerged in the conference, as far as the ENA is aware, for the provision of prospective information.
41. Prospective information would in many cases be commercially sensitive, and entities with listed securities are subject to listing rules related to providing and keeping updated prospective information.
42. The ENA considers prospective information should not be required as part of the disclosed information, other than what is already disclosed in asset management plans.

## Recommendation

- Prospective information should not be required to be disclosed, other than what is already required in asset management plans.

## Cost pass-through for insurance costs

43. A submission from Jardine Lloyd Thompson highlighted the under-reporting of insurance costs to date by lines businesses due to the fact that they self-insure for the majority of their network assets, and do not report the cost of this self-insurance. This issue has implications for the current thresholds.

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<sup>3</sup> See paragraph 164 of the Review Paper.

44. ENA considers lines businesses should be able to recover these under-reported costs of this insurance, and therefore request the Commission allow such costs to be “passed-through” under the current thresholds as they have not allowed for such costs.
45. Similarly, other new risk management costs (such as IT protection) that emerge as tangible requirements due to changing conditions should be recognised as “pass-through costs” where companies comply with new, recognised, industry practices. For example, many control systems have evolved in a period where there was little focus on protection against threats from computer viruses through to physical attacks, and there is a global trend towards tightening up security in these areas (where the costs to consumers, in particular, of any incursions are potentially very large).

## **Recommendation**

- In relation to current thresholds, the Commission should allow the cost of insurance of network assets, which has to date been under-reported due to lines businesses self-insuring, to be a “pass-through cost” under the thresholds.
- Similarly, other new risk management costs (such as IT protection) that emerge as tangible requirements due to changing conditions should be recognised as “pass-through costs” where companies comply with new, recognised, industry practices.