



Development of Information Disclosure Regime

**Powerco's response to the
Process Paper – 14 September
2003**

14 November 2003

Introduction

The Commerce Commission (the Commission) is required under subpart 3 of Part 4A of the Commerce Act 1986 (the Act), to develop an information disclosure regime for large electricity distributors and large line owners (lines businesses). The Commission has released a Process Paper outlining the process that it intends to follow in developing this information disclosure regime. Powerco welcomes the invitation to comment. It believes the industry can make a useful contribution to the disclosure data process. Successful outcomes for the 'light handed' threshold regime will, in part, depend on the suitability and quality of the data used to underpin the regime.

The process and timetable proposed recognise that refinements to the current information disclosure will be necessary. The Commission indicates that it will seek and consider the view of interested parties on any refinements during 2004, with revised information disclosure requirements issued before March 2005.

Powerco understands that the tightness of the timeframe for the 2004 threshold reset allows little opportunity for more detailed consideration of these issues at present. However, given the critical importance of disclosure data in the determination of price and quality thresholds, Powerco would expect that priority be given to initiating the refinement process once the threshold reset has been finalised in March 2004. Data requests often require significant changes to information systems or even installation of additional equipment, in the case of the quality threshold. To have the changes in place for the March 2005 threshold it should be recognised that sufficient time will be required for businesses to make any necessary arrangements.

Impact of regulatory regime on information disclosure

The use of the disclosure data for statistical analysis of lines business performance represents a significant expansion of its original purpose. It will require some modification and possibly some extension, or at least replacement of the data required.

Information disclosure when first introduced was part of New Zealand's 'light-handed' regulatory regime. The data was intended as information only, to inform likely competitors and the general public. Providing greater transparency to line-users, the disclosed information was to be presented in "user-friendly" summaries to make the data more accessible to the general public.

However, use of the database for analytical assessment of comparative business performance will require a number of changes to the disclosure data regime. Firstly, it will require a level of integrity and comparability of the data that exceeds that of the existing data. Secondly, it will require introduction of new data categories more appropriate to the modelling process. As an offset, the quantitative approach to performance assessment will provide an opportunity to

reduce the overall level of data previously deemed necessary for information purposes.

Data integrity most likely will be improved by the change in purpose. The knowledge that data disclosed could impact on future revenues should have a positive effect on accuracy and consistency. Comparability, however, will require possible changes to the disclosure regime, at least as far as it relates to the lack of sharply defined expenditure categories and cost allocations.

Identifying the new categories of data required to facilitate more robust comparison of business performance may also require modification of the requirements for disclosure data. Experience suggests that data best suited for modelling purposes is not always readily available from standard corporate reporting systems.

Use of the ODV Handbook

In its draft decisions of 31 January 2003, the Commission proposed to use the ODV valuation report approved by the Commission (pursuant to section 57ZC of the Act) subject to additions and disposals as the opening valuation of system fixed assets as at 31 March 2003.

In paragraph 11 of the process paper the Commission signals its intention to require the use of newly developed ODV Handbook for the purposes of information disclosure (2003/04 year).

In paragraph 10, the Commission signals an intention to rely on the ODV Handbook in relation to the targeted control regime under subpart 1 of Part 4A and to the possible imposition of control under Part V of the Act.

In paragraph 11 the Commission makes the following comment in regard to the use of the new valuations

“... and would provide the opening valuation under the targeted control regime for the new regulatory period beginning in 2004”.

Powerco has grave concerns over the linking of information disclosure and price control in this manner. There is nothing in the Act that links subpart 1 with subpart 3. Indeed the purpose section in subpart 3 – section 57T(1) does not refer to information disclosure being an input into control. Rather it is intended to inform a wide range of people about relevant information – quite a different concept!

Powerco therefore repeats the assertion made in previous submissions that there is nothing in the information disclosure subpart of the Commerce Act that requires the Commission to rely upon the ODV Handbook when it declares control under subpart 1.

Furthermore Powerco submits that the ODV Handbook, at least in its present form, is deficient for the purpose of compiling a valuation of line business assets for the purpose of setting thresholds for price control or the application or operation of the threshold regime.

That is to say any asset valuation used to assess price, profitability or the absolute efficiency of a lines business must be derived from the value of the entire business:

- System fixed assets – which may be derivable from an updated Handbook similar to the MED ODV Handbook; and
- Non-system fixed assets – whose value is the difference between the value of the lines business under FRS-3 and the system fixed asset value.

Given that that it is not possible to derive an FRS-3 “fair value” for non-system fixed assets using a Handbook in the way proposed for system fixed assets, but that the new uses proposed for the ODV would require these assets to be valued, the isolation of a system fixed asset value derived using a Handbook appears to be irrelevant.

The proposal to use the new valuations to provide the opening valuation under the targeted control regime for the new regulatory period beginning in 2004 is therefore in Powerco’s view totally inappropriate until the outcome of the review of the Handbook is known.

Whatever this outcome maybe, it is imperative that the regulatory asset base used for targeted threshold price path determination or any price control purpose includes the value of both system fixed assets and non-system assets.

Process

Refinements to the information disclosure process have already been introduced. The Commission issued limited information requirements on 6 June 2003. These were designed to support the assessment of lines businesses against the first price/quality thresholds. They set down procedures for the disclosure of information by the lines businesses on their compliance or otherwise with the thresholds. No material changes to the disclosure data were involved.

The next step in implementing subpart 3 of Part 4A of the Act is to develop an information disclosure regime for the lines businesses. In the first instance, the Commission has indicated that its data requirements will largely replicate the existing regime provided in the Regulations and MED’s Information Disclosure Handbook. Subsequent refinements will be developed overtime, with a major review occurring during 2004.

The debate relating to the setting of the price/quality thresholds has drawn attention to the quality, and even relevance, of some of the disclosure data. It has emerged as a key issue in the development of credible performance comparisons. The Commission acknowledged the problems presented by the quality of the data in its Draft Decision. In an earlier report, into asset valuations, PB Associates suggested that lack of clear guidelines on asset valuation and expenditure classification had resulted in multiple interpretations of the rules. The Meyrick & Associates (Meyrick) Report for the Resetting of the Price Path Threshold echoed this finding when it observed, “the consistency and quality of

the data is extremely variable. The distributors appear to have interpreted what is required differently...”.

Powerco notes that PB Associates made a number recommendations in their report to be considered in the review of the ODV Handbook. We believe that the comments made are worth re-stating since they go to the heart of the data problems encountered by Meyrick in undertaking its performance analysis.

Commenting on their audit of optimised deprival valuations of system fixed assets of lines businesses PB Associates observed that the quality of valuation reports varied significantly. Without adequate asset records accurate assessment of assets was not possible with a number of businesses simply estimating asset ages and asset quantities. Moreover, the problem would continue while some businesses lacked the procedures to maintain asset registers on an ongoing basis.

PB Associates also noted that differing interpretations of the ODV handbook requirements contributed to an inconsistent application of the regulations. In this respect they made a number of recommendations for improvements to the ODV handbook. Mostly, they were to facilitate interpretation and improve consistency in reporting.

These shortcomings will need to be addressed in the development of the new ODV handbook if the purpose of the data is to go beyond that of simply providing information to an interested community. Efficient replacement investment requires an accurate assessment, not an estimate, of the age of the current assets. Equally important is the development of robust asset inventories. Meyrick and Associates based the choice of a production model rather than cost model on the grounds that physical quantities of inputs were likely to be more accurate than financial measures. The PB Associates report suggests this may not be the case.

Extending the purpose of the disclosure data to the statistical analysis of comparative performance raises new and perhaps additional issues. Changes to the ODV Handbook need to be mindful of the new role of the data in the new regulatory regime.

Powerco has additional concerns in regard to the use of the ODV Handbook for valuation of electricity line business assets and these are detailed in our submission on the development of the ODV Handbook.

Reviewing the disclosure data regime

The Commission has indicated that it will conduct a major review of the disclosure data requirements during 2004. As Powerco has already noted, instituting data collection systems can take time and resources. Some changes could require at least 12 months notice, as acquisition procedures may need to be implemented ex ante rather than ex post. Accordingly, commencing the review process at the earliest possible time will provide the industry with more opportunity to implement the required systems.

Information regimes in other countries have often been developed in conjunction with the industry. The UK Information and Incentives Project was a cooperative effort and took place over a number of years. In Ontario the data issue was addressed by a series of joint working groups and as part of the lead-in to the new regulatory regime. Cooperative development of the disclosure regime helps to facilitate the selection of data that is not only adequate to the purposes of the regulator but also relevant to the actual cost performance of the industry.

Accordingly, Powerco would like to propose that the major review of the disclosure data be conducted as a cooperative project between the Commission and the industry. Given the use of the data in statistical assessment of performance, it could also be useful to involve relevant expert analysts.

The task is to develop a dataset that is appropriate to its purpose and robust in its delivery. Robust data is an essential input to the thresholds process. The nature of the threshold regime, with compliance against targets, also requires stability in the data series over time. Stability is best achieved by a major review that examines thoroughly the key issues, which could include:

- data requirements of the Commission under subpart 3 of Part 4A of the Act;
- data requirements for analysis related to the comparative option;
- relevance of, and possible changes in, the existing data requirements. In this regard Meyrick noted that the scope of the disclosure data was possibly larger than that necessary for information purposes; and
- development of definitions that are clear and meaningful in terms of the technical parameters of the industry.

and then establishes the new regime as a once-off project. Constant and ongoing refinement of the data requirements will not produce the necessary stability. Volatility of the data on a year-to-year basis has been one of the major hurdles to credible assessment of the B and C factors.

Conclusion

The change in purpose of the disclosure information places particular emphasis on improved data quality. In this respect, Powerco welcomes the Commission's proposed major review of the disclosure requirements. However, the problems encountered with the integrity and comparability of the existing data suggest that a cooperative project between the Commission and the industry to develop the new data regime would be beneficial. Powerco would recommend such an approach. It would also recommend the earliest possible start to the data review given the lead time required to implement some data acquisition systems.

The proposal to use the valuations in accordance with the new ODV Handbook to provide the opening valuation under the targeted control regime for the new regulatory period beginning in 2004 is totally inappropriate until the outcome of the review of the Handbook is known. Whatever this outcome maybe, it is

imperative that the regulatory asset base used for targeted threshold price path determination or any price control purpose includes the value of both system fixed assets and non-system assets.