



8 March 2008

Network Performance Group  
Commerce Commission  
PO Box 2351  
Wellington

Mighty River Power Limited  
Level 19, 1 Queen Street  
PO Box 90399  
Auckland

Phone: +64 9 308 8200  
Fax: +64 9 308 8209  
[www.mightyriverpower.co.nz](http://www.mightyriverpower.co.nz)

To whom it may concern,

## **Review of the Information Disclosure Regime**

### **Introduction**

1. Thank you for the opportunity to make a submission in response to the Commerce Commission's consultation paper "Review of the Information disclosure Regime", dated 20 December 2007. No part of our submission is confidential and we are happy for it to be publicly released.

### **Public disclosure**

2. Mighty River Power believes that **all** information required to be disclosed under the Electricity Information Disclosure Requirements should be required to be disclosed on the electricity lines businesses' (ELBs') websites. This would make it easier for interested parties to access disclosed information, thereby promoting transparency. There would be negligible additional compliance costs for ELBs. If anything their compliance costs could be reduced as less interested parties would need to rely on the ELBs making copies of the information for the interested parties. Accordingly, Mighty River Power **recommends** the definition of publicly disclose be amended to include disclosure on the ELB's website. There would be various minor consequential amendments that would be needed to the Disclosure Requirements as a consequence of this recommendation.

### **Avoidable cost allocation methodology**

3. Mighty River Power **notes** we support the application of the Avoidable Cost Allocation Methodology (ACAM) for the purposes of determining ELBs' financial statements and performance measures.
4. The use of ACAM/stand-alone cost is appropriate for determining whether an ELB is earning excessive returns and for setting a ceiling for line charges. The appropriateness of ACAM for this role is effectively acknowledged by the Commerce Commission's

proposed pricing principle 4 for Vector and Powerco's gas pipeline businesses.<sup>1</sup> Any revenue earned in excess of stand-alone cost reflects monopoly profits.

5. Fully allocated cost methodologies (FACM) do not identify whether monopoly profits are being earned, and the results of application of FACM will be a function of arbitrary cost allocations.
6. To see this, take the following stylised example:
  - IC ELB = \$10.
  - IC Generation Service = \$2
  - CC = \$3.
7. ACAM will tell you that the ELB is monopoly pricing if the line revenue exceeds \$13, and the generation service is uneconomic/being subsidised if the generation revenue is less than \$2.
8. Let's say the application of FACM results in common costs being equally shared between the ELB and Generation Business. This would incorrectly suggest that the ELB is monopoly pricing if line revenue exceeded \$11.50, and the generation business was being subsidised if its revenue was less than \$3.50. Both propositions would be incorrect.
9. The Commerce Commission criticises ACAM on the basis that "ACAM allows the business to retain all of the efficiency benefits that might be achieved by economies of scope". The problem with this statement is that it implicitly over-extends the function of financial disclosures – which is to identify excess profits and/or cross-subsidisation. The functioning of the thresholds regime (CPI-X) under the Commerce Act will, if well operated, incentive ELBs to find ways of improving efficiency (including through economies of scope) and that these are shared with consumers (through line charge reductions over-time).
10. Mighty River Power accordingly does not agree with the Commerce Commission that "ACAM allows monopoly businesses to subsidise the cost of providing competitive services".<sup>2</sup> There may be scope to make the ACAM rules more prescriptive though in order to reduce the risk that ELBs misapply ACAM by over-allocating costs/assets to the ELB (beyond stand-alone cost). One way the Commerce Commission could test whether this is an issue is to do a time-series analysis of disclosed costs on ELBs who have expanded into provision of other services (such as electricity generation) to see whether such activity coincides with increased ELB costs.

---

<sup>1</sup> Commerce Commission "Draft decisions paper – pricing principles, guidelines, and reporting requirements", 7 December 2007.

<sup>2</sup> Paragraph 85, bullet two.

11. We acknowledge the Commerce Commission's comment about double-counting of costs for businesses with electricity and gas networks. The separate operation of information disclosure requirements for gas and electricity means ACAM is not presently fully applied to multi-network utilities, i.e. the disclosure requirements identify whether GPB revenue exceeds stand-alone cost (if GPBs choose to use ACAM<sup>3</sup>) and whether ELB revenue exceeds stand-alone cost, but does not test whether combined GPB + ELB revenue exceeds their joint stand-alone costs.<sup>4</sup>
12. The Commerce Commission could remedy this by requiring multi-network ELBs to separately disclose any common costs/assets. This would then allow the Commerce Commission to create joint GPB-ELB financial statements and financial performance measures (by adding the GPB and ELB financial statements together, and then subtracting common costs/assets to eliminate double counting).<sup>5</sup>

### Pricing methodologies

13. Mighty River Power agrees with the Commerce Commission that the Electricity Commission's development of a model approach to distribution pricing may impact on the appropriate line charge and pricing methodology requirements. For example, the impact will depend on whether the Electricity Commission introduces:
  - a. A voluntary or mandatory distribution pricing methodology. If the Electricity Commission introduces a voluntary distribution pricing methodology it would be appropriate for the Commerce Commission to require disclosure of deviations (including rationale and price impact) from the model distribution pricing methodology. If the Electricity Commission introduces a mandatory pricing methodology a requirement for ELBs to disclose the methodology would become redundant.
  - b. Its own pricing methodology disclosure requirements – just as it is overlapping the function of the Electricity Information Disclosure Requirements with transmission service quality disclosure requirements (additional to the service quality disclosure requirements in the Electricity Information Disclosure Requirements).

---

<sup>3</sup> The Ministry of Economic Development is yet to implement the ACAM requirements it developed for gas.

<sup>4</sup> Joint ELB + GPB stand-alone costs = ELB stand-alone costs + GPB stand-alone costs - common costs.

<sup>5</sup> The Ministry of Economic Development identified how the issue of multi-network utilities (including GPBs that provide both gas transmission and distribution services) should be dealt with under ACAM in its consultation papers on "Proposals for Amending the Gas (Information Disclosure) Regulations 1997", published on 13 October 1999 and 10 February 2000. These papers can be found at:

[http://www.med.govt.nz/templates/MultipageDocumentPage\\_10150.aspx](http://www.med.govt.nz/templates/MultipageDocumentPage_10150.aspx) and

[http://www.med.govt.nz/templates/MultipageDocumentPage\\_10121.aspx](http://www.med.govt.nz/templates/MultipageDocumentPage_10121.aspx), respectively.

14. Further, on the matter of pricing methodology disclosure, the Commerce Commission could draw on the pricing methodology reporting requirements the Commerce Commission is proposing for Vector and Powerco's gas pipeline businesses (GPBs),<sup>6</sup> such as requirements for a "Tariff Strategy Report".
15. We also note the comments we recently made on gas pricing methodology disclosures.<sup>7</sup> We made the observation that the Ministry of Economic Development conducted a review of the Gas (Information Disclosure) Regulations 1997 in 1999/2000 and developed gas pipeline pricing methodology disclosure requirements that would have been superior to those under the Electricity (Information Disclosure) Regulations (now Requirements).
16. The Ministry proposed to amend Regulation 20 of the Gas Information Disclosure Regulations so that methodology disclosures must:<sup>8</sup>
  - a. Describe the methodology used to calculate the charges;
  - b. Include the key components of the revenue required to cover costs and profits of the pipeline owner's pipeline business activities, including cost of capital;
  - c. State the consumer groups used to calculate the charges, including:
    - i. the rationale for the consumer grouping;
    - ii. the method by which the pipeline owner determines which group consumers are in; and
    - iii. for each of these consumer groups, the statistics relating to that group which were used in the methodology;
  - d. Describe the method by which the pipeline owner allocated the components of the revenue required to cover the costs of its pipeline business activities amongst consumer groups, including the rationale for allocation; and
  - e. Describe the method by which the pipeline owner determined the proportion of fixed and variable charges, and the rationale for those proportions.
17. Implementation of these changes was put on hold by the Government pending review of the gas industry and they were never subsequently actioned. Given the Commerce Commission has concerns about tariff setting, and there is no reason to believe these concerns are specific to Vector and Powerco, Mighty River Power **recommends** that the Commerce Commission draw on the intended Gas (Information Disclosure) Regulation amendments when it reviews the line charge and pricing methodology disclosure requirements.

---

<sup>6</sup> Commerce Commission "Draft decisions paper – pricing principles, guidelines, and reporting requirements", 7 December 2007.

<sup>7</sup> Mighty River Power "Draft Decision on authorisation of price control of Natural Gas Distribution Services", 29 November 2007,

<sup>8</sup> [http://www.med.govt.nz/templates/MultipageDocumentTOC\\_10144.aspx](http://www.med.govt.nz/templates/MultipageDocumentTOC_10144.aspx)

### Independent auditor

18. Mighty River Power **notes** that we do not consider it appropriate for a firm that assists an ELB in the preparation of information for disclosure to also audit the same firm's disclosures, and accordingly we support the Commerce Commission's proposed amendment of the definition of independent auditor.
19. Mighty River Power would go further than this though. We believe any firm providing auditing services to an ELB for information disclosure purposes should be precluded from providing any other (e.g. consultancy services) to that ELB. Accordingly, Mighty River Power **recommends** that the definition of independent auditor be amended to include a sub-bullet along the following lines "has not provided the Distribution business with any other services in the year to which the audit report will relate or in the previous 3 years".

### Transitional requirements

20. Mighty River Power **recommends** "Original requirements" that are continuing under the revised Requirements be inserted into the revised Requirements instead of the revised Requirements cross-referencing (under draft Requirement 14) the Original Requirements. We believe this would be more user-friendly. It would be more difficult for interested parties to understand what information they are entitled to access if they have to refer both to the revised Requirements and the Original Requirements.

### Concluding remarks

21. If you have any queries regarding Mighty River Power's submission, or would like further information, please do not hesitate to contact either me (on 09 308 8259 or [robert.allen@mightyriver.co.nz](mailto:robert.allen@mightyriver.co.nz)).

Yours sincerely,

**Robert Allen**  
Regulatory Manager