

MAJOR ELECTRICITY USERS' GROUP

11 September 2009

John Hamill
Manager
Network Performance Branch
Commerce Commission
By email to NPB@comcom.govt.nz

Dear John

Submission on Information Disclosure Discussion Paper

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission's, "Information Disclosure Discussion Paper," published 29th July 2009¹ (the "Discussion Paper").
2. Because of the importance of Asset Management Plans (AMP) in the proposed information disclosure regime, MEUG commissioned Strata Energy Consulting to provide an independent expert view on proposals and questions in the Discussion Paper in relation to AMP's. A copy of the briefing note by Strata Energy Consulting "Commerce Commission Information Disclosure Discussion Paper – 29 July 2009" dated 7th September 2009 is attached (the "Strata report on use AMP for Information Disclosure"). MEUG agree with the comments of Strata.
3. Comments ordered by chapter headings in the Discussion Paper follow. Comments on chapters 2 to 10 apply to the generic application of information disclosure to the four regulated sectors of electricity distribution lines services, Transpower, gas pipeline services and specified airport services. Comments on information disclosure requirements for Electricity Distribution Businesses (EDB) and Transpower are covered in chapter headings 11 and 12.

Chapter 2: Statutory framework and regulatory framework principles

4. The design of an information disclosure regime should consider and reinforce longer term changes that will give effect to the Part 4 purpose statement. A progressive shift to a contractual relationship between regulated monopolies and their customers that specifies service standards and liabilities should, in the view of MEUG, underpin the regulatory framework. The initial Transmission Benchmark Agreement is a good step in this direction. Contracts allow consumers to understand what service they can expect to receive and regulated businesses to focus resources to meet contract terms including minimising liability.
5. A strong regulatory environment is needed to overcome the imbalance in bargaining power to ensure such contracts are even-handed. In summary the focus in future should be on performance of contract terms and conditions, rather than the institutions themselves, with the regulator assisting formation and evolution of those contracts. We mention this goal of shifting to more of a contractual basis because it underpins many of the comments that follow.

¹ Refer <http://www.comcom.govt.nz/IndustryRegulation/Part4/DecisionsList.aspx>

6. In addition to the four implementation principles² of consistency, transparency, cost-effectiveness and flexibility, the Commission should also consider timeliness. In the electricity sector there is a mismatch between when consumers must pay for line services and when they have access to data on the quality of line service provided. Taking a sawmill as an example, that business must pay line charges monthly irrespective of line service quality and is expected to be satisfied with an EDB entity averaged quality report 5 months after the end of the statutory reporting year. This is not what happens in competitive markets. Consumers can usually detect poor service and give immediate feedback to suppliers. We think it reasonable that the sawmill in this case should be provided information on any quality deviations when being invoiced line charges the following month and a report no later than 3 months after the end of the reporting year summarising quality performance for the year for that sawmill and comparing that with every other consumer on the same tariff class. This is timely and useful information that allows the sawmill owner to ask questions of the EDB if quality starts to deviate from the tariff class average or historic average.

Chapter 3: Monitoring performance

7. MEUG agrees with the comments on page 11 of the Strata report on use of AMP for Information Disclosure on whether AMP can be used to demonstrate innovation and investment (question 9).
8. MEUG recommend two major enhancements to monitoring performance: disclosure of CEO compensation contracts and summarising information in an "Annual Regulatory Performance Tree." These proposals are set out in the following two subsections.

Chapter 3: Monitoring performance – Disclosure of CEO compensation contracts

9. MEUG recommends that the Commission enhance Information Disclosure by requiring disclosure of the form and basis of supplier CEO compensation contracts and alignment to Part 4 Purpose Statement 52A (a) to (d).
10. Section 53B (2)(j) and (d) provide for disclosure of "contracts" and "assumptions, policies, and methodologies used or applied ..."
11. CEO compensation contracts normally contain performance standards and thresholds linked to the supplier firm (or group of suppliers such as for gas pipelines and electricity distribution) business objectives. Disclosure of the performance structure provides information on the alignment (or otherwise) with Part 4 Purpose Statement. Knowing how the CEO is incentivised will inform interested parties as to potential future behaviour of the supplier.
12. The greater the alignment of the CEO compensation performance contract with the Purpose Statement the need for detailed disclosure is less. 100% alignment of CEO incentives with Purpose Statement would potentially eliminate the need for all but basic disclosure.
13. Recent New Zealand precedents provide reference points for the Commission's considerations:
- a) Telecom Separation Undertakings:

"20. How have wholesale incentives been handled?"

The Separation Plan requires that the Head of the Wholesale's group incentive be less [than] the 30% of total remuneration in any year, and that the group incentive be less than the total of all other incentive payments (which are related to Wholesale Unit performance). The undertakings also require that an employee who reports directly to the Head of the Wholesale unit and who is responsible for relevant services, must not receive a payment that relates to the performance of the group as a whole. These requirements will ensure that key managers incentives are aligned with non-discriminatory requirements."³

² Discussion Paper paragraph 73

³ <http://www.scoop.co.nz/stories/PA0803/S00508.htm>

- b) The Chairman of Telecom announced on 8th September 2009 that he planned to discuss at the October 1 meeting (AGM), in a broad way, the key performance indicators set by Telecom's board for Dr Paul Reynold's pay.

"But I still think it's incumbent on us to give a broad picture of what we expect of Paul and what our expectations are looking into the future," Mr Boyd said.⁴

14. The Commission proposes requiring supplier disclosure of delegated authority policies (paragraph 496 and 499) on the basis of the potential affect on profitability or financial viability. Disclosure of CEO compensation contracts is complementary to delegated authority disclosure. Telecom has agreed to an eleven point decision specific list of authorities for the manager of the ANS Unit (now called Chorus).⁵

Chapter 3: Monitoring performance – Annual Regulatory Performance Tree

15. MEUG recommends that the Commission enhance Information Disclosure by summarising information in the form of an "Annual Regulatory Performance Tree".
16. Section 53B (2) (b) outlines the Commission's summary and analysis obligations and the purpose of that summary and analysis. It specifies that the Commission:

"must, as soon as practicable after any information is publicly disclosed, publish a summary and analysis of that information for the purpose of promoting greater understanding of the performance of individual regulated suppliers, their relative performance, and the changes in performance over time."

17. The disclosure imperative is for each supplier to provide base information to the Commission so it can provide performance and analysis including benchmarking to inform interested parties.
18. The Commission proposes to require information in the general form as set out in Table A (paragraph X12, pIII). The package of information includes annual financial data, 10 year Asset Management Plans, forecasts, annual qualitative measures, physical units, etc.
19. The package of information and indicators to be disclosed by suppliers to the Commission and then to interested parties should be in a form that allows absolute and related linkages of performance to be readily accessible by interested parties.
20. The disclosure information components proposed by the Commission are essentially linked. The information package is standardised for each of the four network services. The Commission proposes that disclosures be made available in an Excel template (paragraph 516). Benchmarking within each service follows from a consolidation of supplier data.
21. The addition of a visual presentation of the inputs and linkages can provide an intuitive and yet simple lens on most of the Information Disclosure or at least the essential summary view of annual performance absolutes and comparatives (including years to date).
22. MEUG recommends that the Commission consider adapting the traditional Du Pont chart analysis for each of the four services. We term the version of such a chart as an "Annual Regulatory Performance Tree" (ARPT).
23. The key fundamental performance indicator proposed by the Commission is the Return on Investment (ROI). ROI is an end product of the build up in financial, physical and qualitative inputs. ROI reflects the residual return generated from Regulated Assets and other processes.
24. Figures A⁶ and B⁷ below are textbook examples of the flexible use of the Du Pont approach.

⁴ <http://www.nzx.com/print/2843244>

⁵ Telecom Separation Undertakings 25 March 2008

<http://www.comcom.govt.nz/IndustryRegulation/Telecommunications/OperationalSeparationofTelecom/ContentFiles/Documents/Telecom%20Separation%20Undertakings.pdf> Schedule 4 p166.

⁶ Copeland, Weston and Shastri, "Financial Theory and Corporate Policy", 4th edition 2005, p474

⁷ Savarese, C., "Economic Value Added", 2000, p286

FIGURE A

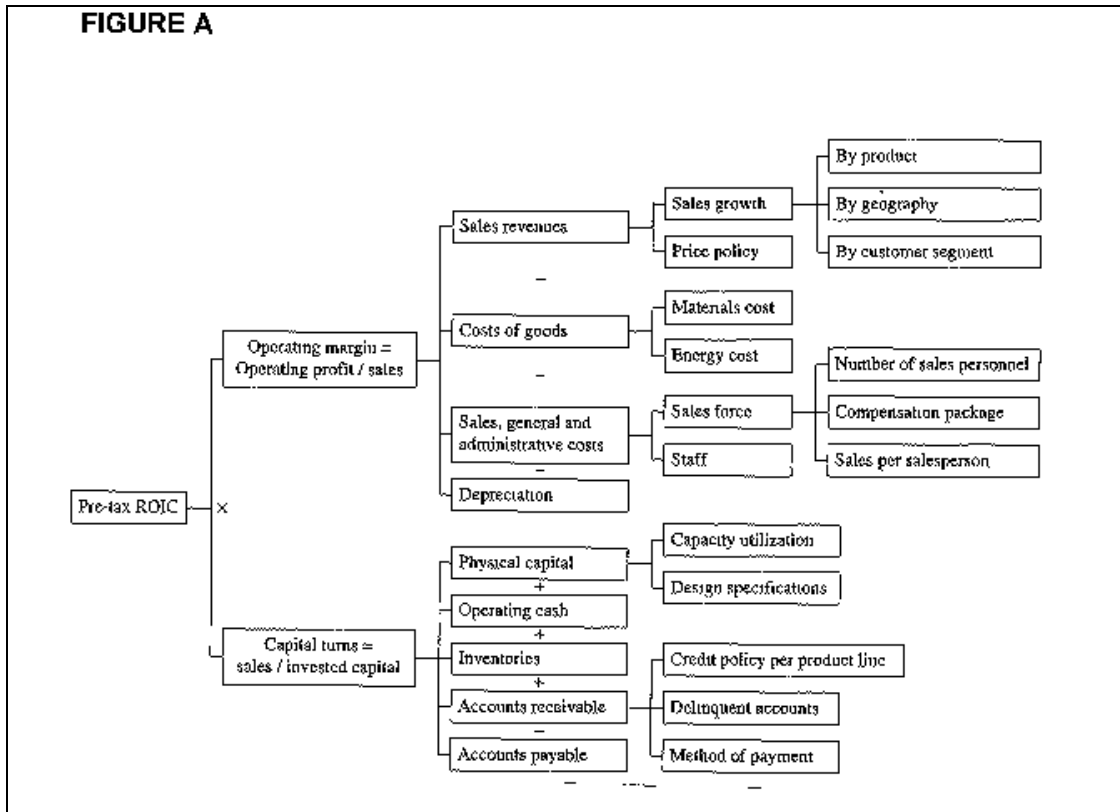
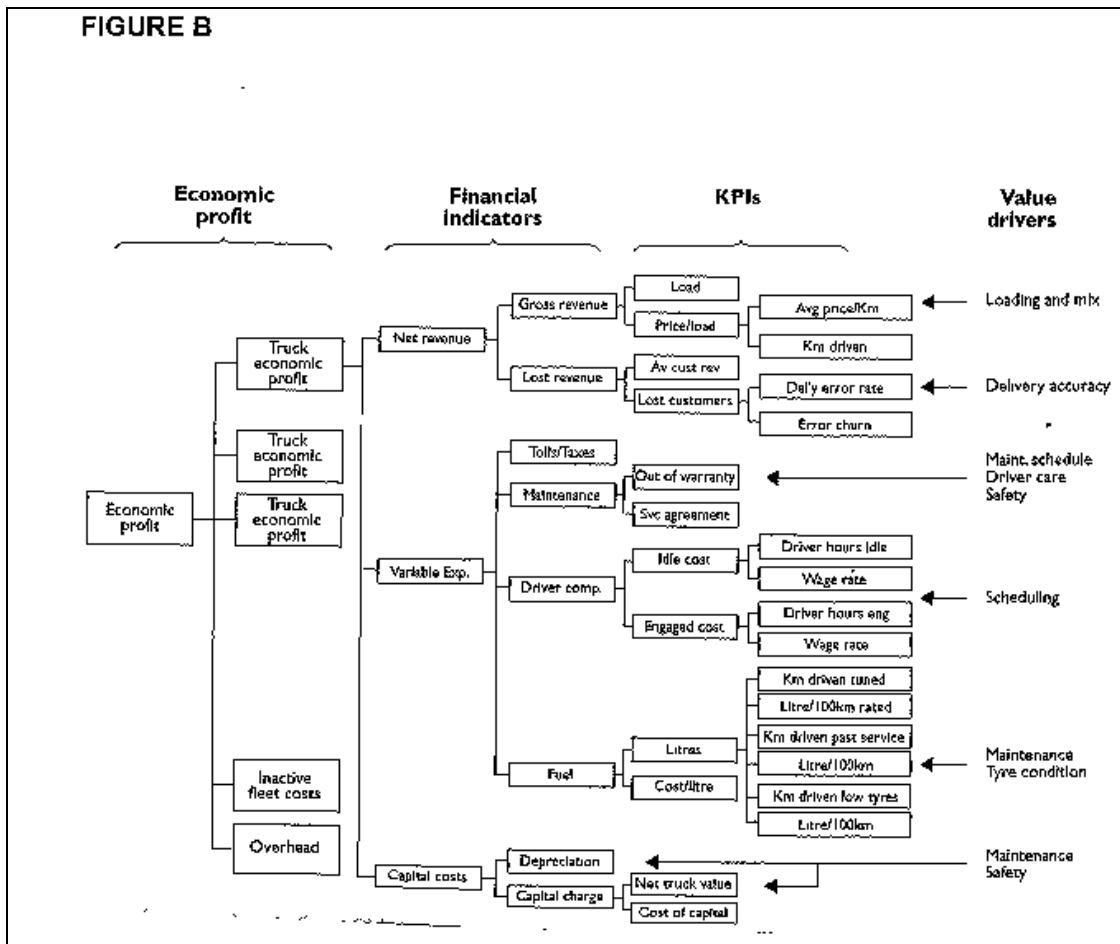
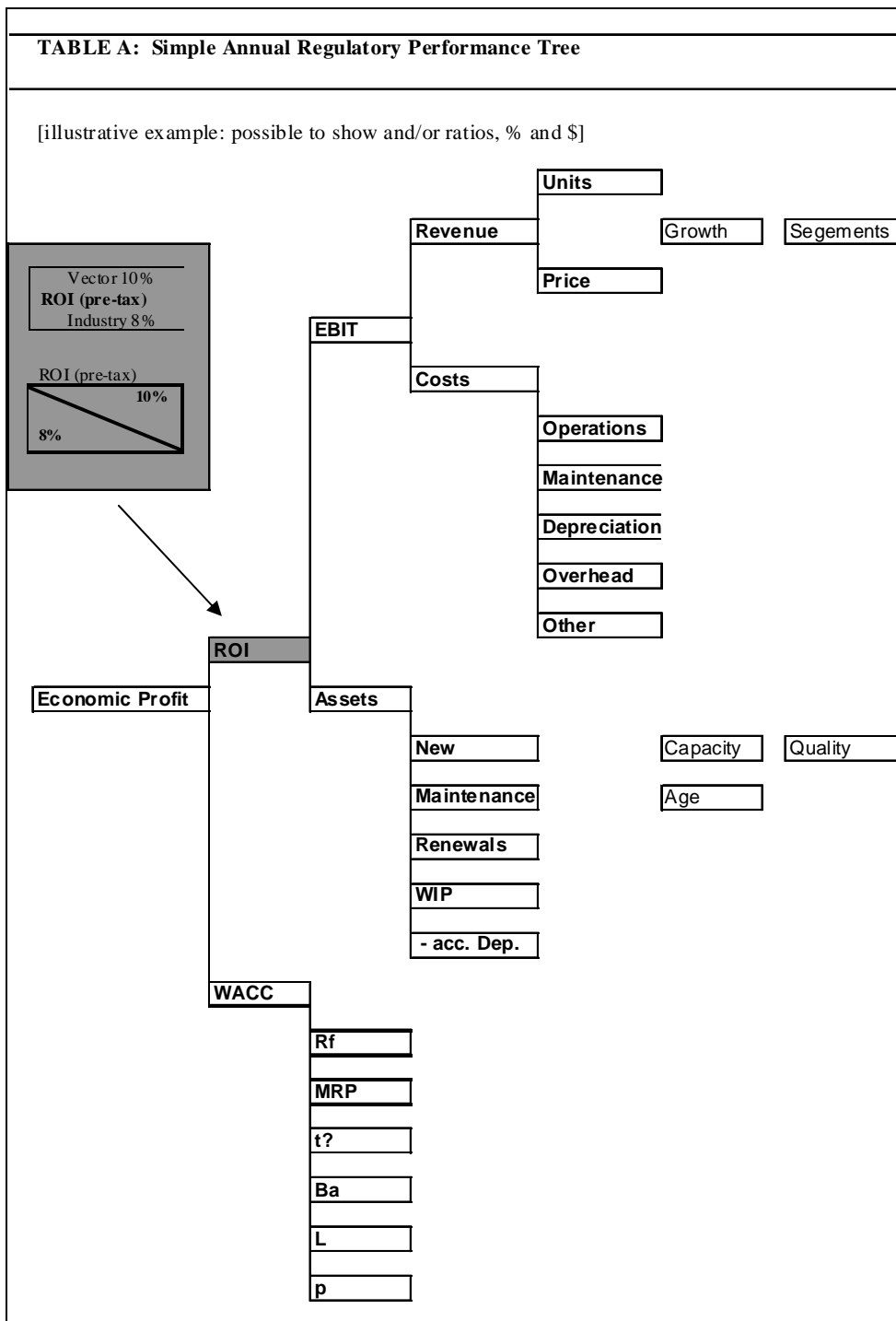


FIGURE B



- 25. For each service, Electricity Distribution Lines, Transpower, Gas Pipelines and Specified Airports, specific ARPTs should be designed by the Commission based on Tables 16 and 17, 18 and 19, 20 and 21, 22 and 23 respectively.
- 26. The flexibility of the Du Pont chart approach can be demonstrated for benchmarking: at each node comparative information can be displayed. See the "ROI node" in Table A below.
- 27. The visual representation of the Information Disclosure provides a new perspective on absolute and relative performances and variable linkages. This promotes greater understanding of performance and better informs interested parties.



Chapter 4: Return on Investment

28. Reporting actual ROI does not give consumers a measure of the dollar value of profits from which an assessment of the dollar value of excess profits can be made. For example take two EDB both reporting a very high ROI well above all commentators' views on WACC, one EDB with a high RAB and the other with a very small RAB. The excess profits earned by the EDB with the high RAB deserve more attention of policy makers and regulators. The best performance indicator to allow consumers to understand profits, including excess or lower than optimal levels, is to track Economic Value Added (EVA) over time as reported by Transpower. MEUG suggest a similar approach be mandated for EDB. The Annual Regulatory Performance Tree discussed earlier would be a useful way to illustrate and report accumulated economic profits of several years.
29. Requiring disclosure of a post-tax WACC (ie the usual approach in New Zealand to date) and a vanilla WACC (often used overseas) is agreed (question 21, p40) provided the disclosing party publishes a reconciliation between the two. This should be the same for every disclosure; nevertheless this is an area prone to misinterpretation and only disclosure of a complete reconciliation will allow interested parties to fully understand that a consistent approach has been followed.
30. Excluding working capital on the basis that immaterial (paragraph 198) needs to be supported by evidence that this is indeed immaterial.

Chapter 7: Quality disclosure and statistics

31. MEUG agrees with the comments on page 11 of the Strata report on use of AMP for Information Disclosure on whether requisite quality should be disclosed, and if so how, in AMP (question 50).

Chapter 8: Asset Management Plans

32. Detailed responses to the questions on AMP in this chapter are set out in the Strata report on use of AMP for Information Disclosure. MEUG agrees with the comments by Strata.

Chapter 9: Pricing and other disclosure provisions

33. Paragraph 490 notes that disclosure of terms and conditions shouldn't compromise the commercial confidentiality of any single customer. MEUG agrees this is important subject to:
- a) The default position is all information is released. This is the position with most information from Transpower including charges for each GXP; and
 - b) Exceptions to the rule be decided by the Commerce Commission on a case by case basis and not left to the discretion of EDB.

Chapter 10: Publication, retention, certification, statutory declaration and audit

34. Listed companies Vector and Horizon must provide annual reports within 3 months and they have adapted processes to meet that timetable. We suggest 3 months rather than 5 months is an appropriate timeframe for annual Information Disclosures (paragraph 517, p114). Earlier provision of information to consumers will allow earlier feedback that will then assist EDB prepare AMP. An earlier release date has benefits. The Commission should ask EDB what incremental costs they would incur to meet a 3 month rather than 5 month timeframe for publishing annual information disclosures so that an assessment of the benefits against the costs can be made.
35. The Discussion Paper proposes that prices disclosures be made at least 20 working days before being introduced (paragraph 518, p115). MEUG suggest EDB be required to disclose price changes at the same time they give notice to retailers. This will ensure all retailers and potential retailers have access to the new information at the same time and can re-adjust their retail product offering to consumers.

36. We see no reason why disclosure of required contracts (paragraph 518, p115) need wait up to a month before disclosure is required. There are likely to be benefits from informing the market of new contracts earlier. Unless EDB have legitimate reasons for not making prompt disclosure, MEUG recommends two working days.
37. MEUG agrees with the comments on page 12 of Strata report on use of AMP for Information Disclosure regarding:
- a) Should AMP, along with other information, be publicly disclosed (question 71, p114);
 - b) Should AMP, along with other information, be certified by Directors (question 77, p117); and
 - c) Should AMP, along with other information, not require audit reports (question 79, p119).

Chapter 11: Electricity Distribution Lines Services

38. MEUG suggest:
- a) A new separate expenditure category (paragraph 574) listing costs spent on non-asset solutions to meeting network services demanded by consumers. Ideally an independently audited estimate of the opportunity cost of network costs saved should also be disclosed. This would be a useful indicator of innovation by EDB to find other lower cost solutions where network capacity was reaching its limit. The Discussion Paper (paragraph 454) notes non-asset solutions should be specifically covered in AMP.
 - b) Transmission charges should be published disaggregated between connection and interconnection charges (paragraph 578). Connection charges are more "discretionary" than interconnection charges and how EDB manage those can alter charges to consumers.
 - c) EDB be required to provide sufficient explanatory notes for consumers to understand the nature of any operational expenditure allocated to "other" (paragraph 581).
 - d) SIADI, SAIFI and CAIDI should be published for each tariff class (paragraph 608) and consumers advised of their own individual quality statistics. In effect each tariff class represents a separate contract between the EDB and many similar consumers. An individual consumer will be interested in the level of quality they have received compared to others in their tariff class. Individual consumers gain little value from only knowing the aggregate SAIDI, SAIFI and CAIDI for each EDB.
 - e) Unplanned disruptions concern all consumers. Such events are inevitable. What matters is how EDB manage those. MEUG suggest EDB be required to report on service quality using the same service measures in the Benchmark Agreement discussed in paragraph 41 below. EDB will be aware of these as they are parties to the Benchmark Agreement.
 - f) Related to management of unplanned outages is any financial compensation paid by EDB to cover inconvenience caused to consumers. MEUG suggest those financial payments be disclosed as they are a useful indicator of how each EDB manages this issue.
 - g) Full transparency of EDB contracts is recommended. In paragraph 6 we mention disclosure of contract terms and conditions need to be timely and in paragraph 33 the default position should be to disclose with the Commerce Commission deciding any exceptions for reasons of commercial confidence. It's not just existing contracts and relationships that need transparency. MEUG has heard anecdotal reports of new entrant retailers seeking a system use of agreement from EDB but being unable to get a timely response. A useful metric would be for EDB to disclose how many inquiries they have had for new contracts, how long it took to engage in discussions on those and how long to reach a conclusion (either a final new agreement or the inquiry ceased) or still work-in-progress.

- h) Statistics on how load control has been used be disclosed, eg frequency of use and any financial gain (by payment or opportunity cost savings) by the EDB for:
 - i) Management of their network;
 - ii) to manage transmission costs;
 - iii) for Instantaneous Reserves; and
 - iv) at the request of energy suppliers.

This is important to consumers because how an EDB manages controllable load can materially effect costs to consumers.

39. MEUG agrees with the comments on page 12 of the Strata report on use of AMP for Information Disclosure on whether AMP should review initiatives for energy efficiency, demand-side management and loss reduction (question 101, p136).

Chapter 12: Transpower

40. One statistic that would be useful is aggregated Contracted Capacity Service Levels (per Benchmark Agreement rule 36.1(a) (1) A.). How the ratio of aggregate Contracted Capacity Service Levels to total installed capacity trends over time would be of interest.
41. In terms of customer service, requiring publication of the service measures by GXP and in aggregate listed in Part B, Schedule 5 (Service Measures) of the Benchmark Agreement, would be useful, ie:
- a) Length of time taken by Transpower to report a breach of service levels;
 - b) Length of time taken by Transpower to investigate and respond to Complaints about service provided under this Agreement; and
 - c) Length of time taken by Transpower to provide a report following an unplanned interruption to, or degradation of, its transmission service.
42. Paragraph 629 mentions MEUG prior submissions in relation to use of a WACC using current values rather than the Settlement WACC and refers readers to paragraphs 181 to 187 for the Commissions proposed approach. That section does not appear to cover this point though.

Concluding comments

43. This submission is not confidential. We look forward to participating in the cross-submission round and conference.

Yours sincerely



Ralph Matthes
Executive Director