

# **Information Disclosure Requirements for Electricity Distribution Businesses and Gas Pipeline Businesses**

## **Draft Reasons Paper**

Date: 16 January 2012

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## Glossary of Terms and Abbreviations

<b>Term/Abbreviation</b>	<b>Definition</b>
The Act	Commerce Act 1986
AMMAT	Asset Management Maturity Assessment Tool
AMP	Asset Management Plan
The Commission	The Commerce Commission
CPI	Consumer Price Index
Current requirements	Electricity Distribution (Information Disclosure) Requirements 2008 and the Gas (Information Disclosure) Regulations 1997
Discussion Paper	The Commission's Information Disclosure Discussion Paper, published 29 July 2009
Draft ID Determinations	Draft Commerce Act (Electricity Distribution Services Information Disclosure) Determination 2012 Draft Commerce Act (Gas Distribution Services Information Disclosure) Determination 2012 Draft Commerce Act (Gas Transmission Services Information Disclosure) Determination 2012 (all under Part 4 of the Commerce Act 1986)
Draft Reasons Paper	This paper, the Information Disclosure Requirements for Electricity Distribution Businesses and Gas Pipeline Services Businesses Draft Reasons Paper, 16 January 2012
EA	Electricity Authority
EDB	Electricity Distribution Business
ENA	Electricity Networks Association
EV	Economic Value
FCM	Financial Capital Maintenance
FTE	Full time equivalent employees
GAAP	Generally Accepted Accounting Practice
GasNet	GasNet Limited
Gazette	The New Zealand Gazette, published by the Department of Internal Affairs
GDB	Gas Distribution Business
GIC	Gas Industry Company
GIDRs	Gas (Information Disclosure) Regulations 1997
GPB	Gas Pipeline Business (includes GDBs and GTBs)
GTB	Gas Transmission Business
ID	Information Disclosure
ID Guidelines	The Information Disclosure Guidelines published by the Electricity

	Authority in February 2010
IMs	Input Methodologies as determined by the Commission in December 2010
IM Reasons Paper	Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper, dated 23 December 2010
IRR	Internal Rate of Return
MDL	Maui Development Limited
NPV	Net Present Value
NZ	New Zealand
NZICA	NZ Institute of Chartered Accountants
Part 4	New Part 4 of the Commerce Act (1986), inserted by the Commerce Amendment Act (2008). Replaces Part 4A.
Part 4 Purpose	Section 52A of Part 4 of the Commerce Act (1986)
Part 4A	Commerce Act (1986) Part 4A
Powerco	Powerco Limited
Pricing Principles	The Pricing Principles as published by the Electricity Authority for EDBs and by the Commerce Commission for GPBs
RAB	Regulatory Asset Base
Regulated Suppliers	Regulated Entities under Part 4 of the Commerce Act 1986
ROI	Return on Investment
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
Suppliers	Regulated Suppliers
Vector	Vector Limited
WACC	Weighted Average Cost of Capital

## Executive Summary

- X1 This paper seeks feedback on our draft decisions on information disclosure requirements for suppliers of electricity distribution and gas pipeline services, and our draft determinations as set out in the:
- Draft Commerce Act (Electricity Distribution Services Information Disclosure) Determination 2012
  - Draft Commerce Act (Gas Distribution Services Information Disclosure) Determination 2012
  - Draft Commerce Act (Gas Transmission Services Information Disclosure) Determination 2012 (together the draft ID Determinations).
- X2 The Commission welcomes all submissions relevant to these draft decisions and the draft ID Determinations. Submissions are due by **5pm on Friday 24 February 2012**.
- X3 The purpose of information disclosure regulation is to ensure that sufficient information is readily available to interested persons to assess whether the purpose of Part 4 of the Act is being met. In setting the draft ID Determinations, we have considered what information is needed by interested persons to assess whether the long-term benefit of consumers is being promoted, through the promotion of outcomes consistent with those produced in competitive markets, such that Electricity Distribution Businesses (EDBs), Gas Distribution Businesses (GDBs) and Gas Transmission Business (GTBs):
- have incentives to innovate and invest, including in replacement, upgraded and new assets
  - have incentives to improve efficiency and provide services at a quality that reflects consumer demands
  - share with consumers the benefits of efficiency gains in the supply of regulated goods or services, including through lower prices
  - are limited in their ability to extract excessive profits.
- X4 In developing the draft ID Determinations, we have also had regard to a range of other matters including:
- the current disclosure requirements applicable to EDBs and GPBs (namely the Electricity Distribution (Information Disclosure) Requirements 2008 (for EDBs), and the Gas (Information Disclosure) Regulations (1997) (for GDBs and GTBs))
  - the views expressed by interested persons including in prior submissions and in the workshops we have held
  - the pricing principles published by the Electricity Authority.

- X5 We have considered the costs of complying with the disclosure requirements. We have sought to ensure the requirements are cost-effective, and are aligned where possible to industry practices and standards, whilst ensuring there is sufficient information available to interested persons to assess whether the purpose of Part 4 is met.
- X6 The draft ID Determinations follow a major review of ID. They set our draft ID requirements for GTBs and GDBs for the first time, incorporate Input methodologies and the other changes in the Commerce Act, and reflect further consideration of our approach to the disclosure of asset management information in particular. We will now increasingly focus on assessing and monitoring the information that is disclosed. We recognise the importance of building a consistent time series of data for our analysis, and for that by other interested persons, and therefore expect future changes to the ID requirements will be on an incremental basis.

### **What information will be required to be disclosed**

- X7 The draft ID Determinations provides for the disclosure of historical financial information, asset management plans, asset management information (including quality performance measures and forecasts of capital and operational expenditure), pricing methodologies, prices, and other key statistics. In addition, the draft ID Determination sets out publication, certification and audit requirements. Table X1.1 below summarises key features of the draft ID Determinations.
- X8 The draft ID Determinations require disclosure of historical (actual) financial information. GAAP is the starting point for these disclosures but has been modified where necessary for regulatory purposes, including through the application of input methodologies.
- X9 When disclosing historical financial information, EDBs and GPBs are required to apply input methodologies for the valuation of assets (including depreciation and treatment of revaluations), the allocation of common costs, and the treatment of taxation.
- X10 The Commission has also set input methodologies for EDBs and GPBs in relation to the cost of capital. The Commission will use annual estimates of the weighted average cost of capital for EDBs and GPBS under this input methodology to assess whether excessive profits are being earned.
- X11 EDBs and GPBs will be required to disclose an asset management plan at least every two years, and an AMP Update in intervening years to outline material changes.
- X12 An Asset Management Maturity Assessment Tool (AMMAT) has been developed to assist suppliers to disclose on a consistent basis a self assessment of the maturity of their asset management practices for disclosure in the AMP.
- X13 New asset management information templates have been developed. Three of these (network expenditure AMP report, network driver AMP report, and network asset AMP report) are prospective disclosures and specify mainly quantitative information

to be disclosed alongside the AMP. The other templates specify information concerning outcomes (network driver report and network performance report). Operating expenditures have been disaggregated to help interested persons understand what is driving the expenditure.

- X14 The Gas (Information Disclosure) Regulations 1997 (GIDRs) contained disclosure requirements for GPBs. Once finalised, the draft ID Determinations will replace those regulations as they relate to GPBs. The Commission proposes retaining the gas transmission capacity disclosure requirements from the GIDRs, with some modifications. Other gas transmission capacity information is to be disclosed in the AMP.
- X15 All suppliers are required to disclose pricing methodologies, lines charges, and pricing statistics disclosures. EDBs and GPBs are not required to apply a particular pricing methodology but are required under the Draft ID Determination to disclose information about the pricing methodology that they do use. Suppliers are required to explain the extent of consistency with the pricing principles (published by us for GPBs and the Electricity Authority for EDBs), and to explain any inconsistency.
- X16 Different audit and director certifications are required dependent upon the nature of information being disclosed. Audit reports will be required for annual disclosures of historic (actual) information; forecast information will not be required to be audited.
- X17 The disclosure year for GPBs is proposed to commence on 1 October and complete on 30 September. This will align the information disclosure period with the pricing year and the DPP assessment period. For EDBs the disclosure year will continue to commence in April and end in March.
- X18 Various transition provisions are proposed.

**Table X1.1: Overview of the draft ID Determination**

Chapter	Summary of Key Features of the draft ID Determinations
Chapter Three:  Disclosure of Historical Financial Information	The draft ID Determination proposes that financial historical disclosures: <ul style="list-style-type: none"> <li>• include ROI disclosures that are comparable to both a nominal post-tax and vanilla WACC, and that the ROI indicator is derived from the expression for an internal rate of return (IRR) calculation undertaken over a one year period</li> <li>• apply input methodologies</li> <li>• include information on regulatory profit, regulatory tax allowance, term credit spread differential, regulatory asset base, operational and capital expenditure, expenditure forecasts, related party transactions and cost allocations</li> </ul>

Chapter	Summary of Key Features of the draft ID Determinations
	<ul style="list-style-type: none"> <li>• include related party transactions (including transfers between the regulated and unregulated business units of the supplier) at a transaction value which is based on objective and verifiable information</li> <li>• include provision for the roll forward of the RAB and other roll forward balances to the beginning of the initial disclosure year.</li> </ul>
<p>Chapter Four:</p> <p>Disclosure of Asset Management Information</p>	<p>The draft ID Determinations require disclosure of asset management information including:</p> <ul style="list-style-type: none"> <li>• AMPs disclosed at least once every two years with an update to the AMP disclosed in the intervening year</li> <li>• New asset management maturity reporting in the AMP (AMMAT)</li> <li>• Prospective asset management information templates</li> <li>• Gas transmission capacity disclosures (GTB only).</li> </ul>
<p>Chapter Five:</p> <p>Disclosure of Pricing Information</p>	<p>The draft ID Determinations retain current requirements for EDBs and GPBs to disclose pricing methodologies, lines charges, and prescribed terms and conditions of prescribed contracts.</p> <p>Pricing methodologies EDBs and GPBs are required to disclose:</p> <ul style="list-style-type: none"> <li>• the extent of consistency with pricing principles, and explain any inconsistency</li> <li>• a policy on capital contributions, and explain how the amount of a capital contribution is determined.</li> </ul> <p>The requirement to disclose the prescribed terms and conditions of prescribed contracts is continued, with some changes to what terms and conditions have to be disclosed. Some provisions of non-standard prescribed contracts are only required to be disclosed upon request.</p> <p>EDBs are required to disclose information on discretionary discounts and rebates.</p>
<p>Chapter Six:</p> <p>Publication,</p>	<p>The draft ID Determinations require that:</p> <ul style="list-style-type: none"> <li>• historical (actual) financial and non-financial information is to be</li> </ul>

Chapter	Summary of Key Features of the draft ID Determinations
certification, audit and transitional provisions	<p>disclosed five months after the end of each disclosure year</p> <ul style="list-style-type: none"> <li>• prospective information, including AMPs, forecast asset management schedules and pricing methodologies, is to be disclosed prior to the start of the disclosure year (biennially for AMPs)</li> <li>• Directors are to certify most disclosures</li> <li>• notification in the <i>Gazette</i> is no longer required</li> <li>• the initial disclosure year is for the disclosure year ended 2012 (year to 31 March 2012 for EDBs and to 30 Sept 2012 for GPBs)</li> <li>• in the initial disclosure year, EDBs will have additional time to disclose their historical disclosures (7 months after the end of the 2012 disclosure year)</li> <li>• an initial regulatory asset value disclosure is required for EDBs. EDBs are also required to disclose information about any asset adjustment process undertaken in accordance with the IM Determinations.</li> </ul>

# Chapter 1: Introduction

1.1 This chapter outlines the purpose and scope of this reasons paper (**paper**) on the information disclosure (**ID**) requirements for electricity distribution services and gas pipeline services under Part 4 of the Commerce Act 1986 (**the Act**).<sup>1</sup> Submissions on this paper and the draft ID requirements are sought by 24 February 2012.

## 1.1 Purpose of this paper

1.2 This paper sets out, and seeks submitters' views on, our reasoning for the disclosure requirements in the draft ID Determinations published with this paper, being:

1.2.1 the Draft Commerce Act (Electricity Distribution Services Information Disclosure) Determination 2012

1.2.2 the Draft Commerce Act (Gas Distribution Services Information Disclosure) Determination 2012

1.2.3 the Draft Commerce Act (Gas Transmission Services Information Disclosure) Determination 2012 (collectively the **draft ID Determinations**).

1.3 This paper also notes several updates to IMs that may be appropriate in light of our work on ID. These are summarised in Attachment A3. Separate consultation would be undertaken on any proposals to amend the IMs.

## 1.2 Regulated services subject to the draft ID Determinations

1.4 Section 54F of the Act provides that suppliers of electricity lines services are subject to information disclosure regulation. Section 55C provides that gas pipeline services are subject to information disclosure regulation. There are 29 suppliers of regulated electricity lines services (referred to as electricity distribution businesses or **EDBs**) and four suppliers of regulated gas pipeline services (referred to as gas pipeline businesses or **GPBs**<sup>2</sup>).

1.5 EDBs and GPBs currently prepare and publicly disclose information under existing ID requirements.<sup>3</sup> These existing requirements will be superseded when the ID Determinations come into force.<sup>4</sup>

1.6 While this paper and the accompanying draft ID Determinations do not include proposed ID requirements for Transpower, some of the proposals and approaches included in this document may be applicable to the development of new ID requirements for Transpower. Persons interested in the Transpower ID requirements

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<sup>1</sup> All section references in this paper are to the Commerce Act 1986, unless stated otherwise.

<sup>2</sup> GPBs include gas transmission businesses and gas distribution businesses. Where we refer separately to gas transmission businesses in the text of this paper and in the draft ID requirements, we use the term GTBs. We use the term GDBs for gas distribution businesses.

<sup>3</sup> EDBs are currently subject to the Commission's Electricity Distribution (Information Disclosure) Requirements 2008, under the (repealed) Part 4A of the Act. GPBs are subject to ID under the Gas Information Disclosure Regulations (GIDRs), administered by the Ministry of Economic Development.

<sup>4</sup> For GPBs, this is effected through s 55J of the Act.

may submit on this paper and the draft ID Determinations. We will issue draft ID requirements specific to Transpower, and seek submissions specific to those, later in 2012. This paper also notes possible future changes to the ID requirements for suppliers of specified airport services, but does not propose any such amendments at this time.

### 1.3 Process to date

- 1.7 A summary of the key steps in our process for preparing the draft ID Determinations and this paper are summarised in Table 1.1 below.

**Table 1.1: Process to date**

Key papers and events	Dates
ID Discussion Paper released, <sup>5</sup> submissions received	July 2009
Final EDB and GPB Input Methodology Determinations <sup>6</sup>	December 2010
ID Process and Issues Paper released, <sup>7</sup> submissions received <sup>8</sup>	February 2011
Update on Process <sup>9</sup>	April 2011
ID working sessions for EDBs and GPBs <sup>10</sup>	May and June 2011
September Update on Process Paper <sup>11</sup>	September 2011
Emerging Views Briefing on Information Disclosure <sup>12</sup>	7 October 2011

<sup>5</sup> Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009.

<sup>6</sup> *Commerce Act Electricity Distribution Services Input Methodologies Determination*, 23 December 2010; *Commerce Act Gas Distribution Services Input Methodologies Determination*, 23 December 2010; *Commerce Act Gas Transmission Services Input Methodologies Determination*, 23 December 2010.

<sup>7</sup> Commerce Commission, *Information Disclosure Regulation – Electricity Lines Services and Gas Pipeline Services - Process and Issues Paper*, 23 February 2011.

<sup>8</sup> Submissions are on the Commission website at <http://www.comcom.govt.nz/part-4-review-of-electricity-information-disclosure-requirements/> under the heading 'Submissions on Information Disclosure Process and Issues Paper'.

<sup>9</sup> Commerce Commission, *Information Disclosure Regulation – Electricity Lines Services and Gas Pipeline Services - Update on Process*, 15 April 2011.

<sup>10</sup> Copies of agendas, workshop papers and minutes for these workshops are on our website at <http://www.comcom.govt.nz/part-4-review-of-electricity-information-disclosure-requirements/>

<sup>11</sup> Commerce Commission, *Information Disclosure Regulation - Electricity Lines Services and Gas Pipeline Services Update on Process*, 12 September 2011.

<sup>12</sup> Commerce Commission, *Information Disclosure Emerging Views Presentation*, 7 October 2011.

Technical Paper on Assessing Cost Efficiency, <sup>13</sup> submissions received (Nov 2011) <sup>14</sup>	
Technical Reference Group on draft EDB/GPB ID Requirements <sup>15</sup>	October - November 2011
Draft ID Determinations released (EDBs and GPBs), submissions now invited	January 2012

- 1.8 Initially, work on the ID requirements took place alongside the development of IMs relevant to electricity lines and gas pipelines services. We then deferred the review of ID requirements until the relevant IMs were determined in December 2010. Work on the ID requirements re-commenced in February 2011.
- 1.9 Also, in 2010 we determined the ID requirements for specified airports services.<sup>16</sup> As some of the issues and approaches are common across regulated services, this paper refers to submissions on the Airports ID Determination and the accompanying Reasons Paper, in some instances.<sup>17</sup>

#### 1.4 Next steps and submissions on this paper

- 1.10 The next steps in determining the ID Determinations and Reasons Paper are set out in Table 1.2 follows:

**Table 1.2: Next steps**

Next Steps	Indicative due dates
Submissions on draft ID Determinations and reasons paper	24 February 2012
Cross-submissions on draft ID Determinations and Reasons Paper	9 March 2012
Technical (drafting) consultation	March – April 2012
ID Determination finalised (EDBs and GPBs)	May 2012

- 1.11 We invite submissions on this paper and accompanying draft ID Determinations no later than **5pm 24 February 2012**. We also invite cross-submissions on matters raised in submissions to this paper. The purpose of cross-submissions is to ensure that we

<sup>13</sup> Commerce Commission, *Information Disclosure: Approaches for Understanding EDB and GPB Cost Efficiency - Technical Paper for Consultation*, 7 October 2011.

<sup>14</sup> Submissions are on the Commission's website at <http://www.comcom.govt.nz/part-4-review-of-electricity-information-disclosure-requirements/>, under the heading 'Submissions on Approach to Assessing EDB and GPB Cost Efficiency'.

<sup>15</sup> Commerce Commission, *Information Disclosure Technical Reference Group Meeting (31 October to 1 November 2011)*.

<sup>16</sup> *Commerce Act (Airport Information Disclosure) Determination 2010 (Airports ID Determination)*.

<sup>17</sup> Commerce Commission, *Information Disclosure (Airport Services) Final Reasons Paper*, 22 December 2010.

are aware of points of agreement or disagreement on matters raised by other submitters. We therefore request interested persons to focus their cross-submissions in this way. We should receive cross-submissions no later than **5pm 9 March 2012**. All submissions and cross-submissions should be supported by documentation and evidence, where appropriate.

1.12 To foster an informed and transparent process, we intend to publish all submissions and cross-submissions on our website. Accordingly, we request an electronic copy of each submission, and ask that interested persons not provide hard copies of submissions (unless an electronic copy is not available). Electronic copies should be provided in an accessible form (i.e. they are 'unlocked' and text can be easily transferred). If the submission contains confidential information or if the submitter wishes that the published version be 'locked', an additional document labelled "public version" should be provided.

1.13 Submissions should be sent to:

[regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz);

or

John Groot  
Chief Advisor  
Regulation Branch  
Commerce Commission  
P.O. Box 2351  
Wellington 6140

1.14 We will be releasing versions of the draft ID Determinations in a format that will allow submitters to insert tracked changes into copies of the draft requirements.

### **1.5 Proposed technical consultation**

1.15 We propose to undertake limited technical consultation on the drafting of a small number of definitions included in the draft ID Determinations. Where possible, we would like to standardise definitions with existing industry standards and/or practices. We hope this will minimise compliance costs. The proposed technical consultation would allow us to leverage the knowledge of interested persons in finalising certain definitions in the ID Determinations. Accordingly, some terms in the draft ID Determinations are not currently defined, but are stated to be finalised during technical consultation.

1.16 This proposed technical consultation:

1.16.1 would not be an opportunity for submissions on the substantive content and approach to the draft ID Determinations

1.16.2 would be limited to reviewing the drafting of the definitions used in the Asset Management Information schedules of the draft ID Determinations

1.16.3 would occur after we have considered submissions and cross-submissions on the draft ID Determinations being issued with this paper.

1.17 We welcome your feedback on this proposal. As no final decisions have been made on whether or how we undertake this technical consultation, and as its scope will be limited, submitters are encouraged to make comprehensive submissions on the draft ID Determinations by 24 February 2012.

## **1.6 Clarifications of aspects of the draft ID Determinations**

1.18 During consultation, interested parties may wish to clarify part of a draft ID determination to assist in making their submission on the technical drafting of the draft ID determinations. Requests for clarification of the draft ID Determinations can be sent to us at [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz) (marked for the attention of John Groot).

1.19 We will try to answer any requests promptly and will keep a spreadsheet with our responses up to date on our website so other interested parties have access to the same information. Any requests for clarification should be sent to us no later than Friday 10 February 2012. After that date, interested parties should identify any issues with the drafting in their submissions on the draft ID determinations (due by 24 February 2012).

## Chapter 2: Regulatory Framework and General Approach

### 2.1 Introduction

- 2.1 This chapter sets out the regulatory framework under which the Commission makes ID Determinations that will apply to EDBs and GPBs. In particular, it discusses:
- 2.1.1 the key legislative provisions relevant to setting information disclosure requirements, in particular, the purpose of Part 4 and the purpose of information disclosure (section 2.2)
  - 2.1.2 the role of ID in promoting the purpose of Part 4 (section 2.3)
  - 2.1.3 our approach to determining ID requirements, including developing requirements which achieve the disclosure of sufficient information in a cost-effective manner (section 2.4).

### 2.2 Setting ID requirements – key legislative provisions

#### *Part 4 of the Commerce Act 1986*

- 2.2 Electricity lines services and gas pipeline services are subject to ID regulation under sections 54F (electricity) and 55C (gas) of Part 4. For the purposes of regulation under Part 4, electricity lines services has the meaning set out in s 54C of the Act; gas pipeline services has the meaning set out in s 55A.
- 2.3 The effect of being subject to ID regulation is set out in s 53B. This includes disclosing information publicly and providing copies of that information to the Commission.<sup>18</sup> The Act requires that the Commission's ID determinations under s 52P(3) must:
- 2.3.1 set out the requirements that apply to each regulated supplier
  - 2.3.2 set out any timeframes that must be met or that apply
  - 2.3.3 specify the IMs that apply
  - 2.3.4 be consistent with Part 4.
- 2.4 Under s 53C(1), a s 52P determination relating to goods or services subject to ID regulation must specify:
- 2.4.1 the goods or services to which it applies
  - 2.4.2 the suppliers to which it applies
  - 2.4.3 the information to be disclosed
  - 2.4.4 the manner in which the information is to be disclosed

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<sup>18</sup> In accordance with any information disclosure requirements set by way of a determination under s 52P of the Act.

- 2.4.5 the form of disclosure
  - 2.4.6 when, and for how long, information must be disclosed
  - 2.4.7 the IMs that apply
  - 2.4.8 any other methodologies that are required in the preparation or compilation of the information.
- 2.5 Section 53C(2) sets out a non-exhaustive list of the types of information that may be required to be disclosed under ID regulation, including:
- 2.5.1 financial statements
  - 2.5.2 asset values and valuation reports
  - 2.5.3 prices, terms and conditions relating to prices, and pricing methodologies
  - 2.5.4 contracts
  - 2.5.5 transactions with related persons
  - 2.5.6 financial and non-financial performance measures
  - 2.5.7 plans and forecasts
  - 2.5.8 asset management plans (AMPs)
  - 2.5.9 quality performance measures and statistics
  - 2.5.10 assumptions, policies, and methodologies used or applied in these or other areas
  - 2.5.11 consolidated information that includes information about unregulated goods or services.
- 2.6 Pecuniary penalties under sections 86 and 86B of the Act may apply in relation to contraventions of the requirements.

*Purpose of Part 4*

- 2.7 Section 52A(1) sets out the purpose of Part 4 of the Act (the Part 4 Purpose):

The purpose of this Part is to promote the long-term benefit of consumers in markets referred to in section 52 by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods and services—

(a) have incentives to innovate and to invest, including in replacement, upgraded, and new assets; and

(b) have incentives to improve efficiency and provide services at a quality that reflects consumer demands; and

(c) share with consumers the benefits of efficiency gains in the supply of regulated goods or services, including through lower prices; and

(d) are limited in their ability to extract excessive profits.

2.8 Our interpretation of the Part 4 Purpose is that:

2.8.1 the central purpose is to promote the long-term benefit of consumers in markets where there is little or no competition and little or no likelihood of a substantial increase in competition

2.8.2 this central purpose is to be achieved by promoting outcomes consistent with outcomes produced in workably competitive markets such that (a) to (d) occur.

2.9 The Commission's interpretation is set out in more detail in the IMs Reasons Paper for EDBs and GPBs.<sup>19</sup>

#### *Purpose of information disclosure*

2.10 Section 53A of the Act provides that the purpose of information disclosure regulation is '...to ensure that sufficient information is readily available to interested persons to assess whether the purpose of Part 4 is being met'.

2.11 Our interpretation of the key terms 'interested persons' and 'sufficient' information is discussed below in paragraphs 2.20 to 2.24.

2.12 We have sought to design an information disclosure regime that allows an assessment of whether the outcomes occurring in markets for regulated services are consistent with the outcomes produced in workably competitive markets such that the objectives set out in s 52A(1)(a)–(d) of the Act are achieved to the long term benefit of consumers.

### **2.3 Role of information disclosure in promoting the purpose of Part 4**

2.13 An effective information disclosure regime provides transparency to interested persons on the performance of regulated suppliers. This will then provide an ongoing source of information so that trends can be identified and monitored over time, which will allow interested persons to assess whether the Part 4 Purpose is being met.

2.14 Chapters 3 to 5 of this document consider the information required on historic financial performance, asset management, and pricing to assess whether the Part 4 Purpose is being met. Given the Part 4 Purpose, the supply of regulated services is likely to be, and is intended to be, influenced by the relevant type of regulation.<sup>20</sup> Information disclosure regulation not only contributes to the specific purpose set out in s 53A, but it can also promote the Part 4 Purpose by improving the distribution of

<sup>19</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraph 2.4.6

<sup>20</sup> For exempt EDBs, information disclosure is the only form of regulation they are subject to under Part 4.

information between regulated suppliers and interested persons, and by expanding the information available to regulated suppliers (e.g. regarding comparative performance).

- 2.15 Generally speaking, a range of information is available to participants in workably competitive markets which allow consumers and suppliers to compare prices and the quality of goods and services. The ability to make these comparisons is an important driver of competition. In markets with only a single supplier, information disclosure regulation can partly compensate for the absence of this information revelation process; information disclosure regulation can itself therefore promote outcomes consistent with those observed in workably competitive markets.
- 2.16 Placing information and analysis about the supply of regulated services into the public domain can also provide incentives that are consistent with those in workably competitive markets—for example, by providing:
- 2.16.1 sufficient information to help consumers and other interested persons assess the extent to which efficiency gains have been shared with consumers through lower prices or other means (consistent with s 52A(1)(c))
  - 2.16.2 sufficient information to facilitate consumer engagement with regulated suppliers about the desired level of service quality (consistent with s 52A(1)(b))
  - 2.16.3 comparative information on the performance of suppliers to a range of interested persons, ID may facilitate more effective governance and help to identify opportunities – e.g. for value-enhancing trade in assets used to supply regulated services (ie, consolidation of businesses) or management contracting. This in turn may promote incentives for improved efficiency, including efficient investment and innovation (consistent with s 52A(1)(a) and (b))
  - 2.16.4 potentially, better incentives for the management of regulated suppliers to improve performance through the public nature of performance related data, as the scope of this data enables comparisons within and across suppliers. Such comparisons may promote incentives for improved investment, innovation and efficiency, consistent with s 52A(1)(a) and (b).

### *Summary and Analysis*

- 2.17 Section 53B(2)(b) provides 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.

- 2.18 The requirement to publish a summary and analysis confers an ongoing, active role on us in respect of the information disclosure regime after the information disclosure

requirements have been set. Our summary and analysis obligations will also assist interested persons assess whether the Part 4 Purpose is being met.

- 2.19 The publication of such an analysis can itself promote incentives to improve performance by highlighting performance levels, relative performance, and performance trends to interested persons including suppliers.

*‘Interested persons’*

- 2.20 The purpose of ID is to ensure interested persons have sufficient information to assess whether the purpose of Part 4 is being met. We interpret ‘interested persons’ broadly, to include:

2.20.1 regulated suppliers

2.20.2 consumers, and consumer groups

2.20.3 electricity and gas retailers, and their representative groups

2.20.4 central government and regional authorities

2.20.5 other regulatory agencies, such as the EA and the Gas Industry Company (GIC)

2.20.6 any other stakeholder of the regulated supplier, including investors and their advisers (such as equity analysts and other professional advisers), and owners of regulated suppliers.

- 2.21 The Commission is also a key interested person.<sup>21</sup>

*‘Sufficient’ information*

- 2.22 ID is a specific form of regulation under Part 4, with its own clearly defined purpose in s 53A, independent of other regulatory instruments. As a result we also consider that the requirement for ‘sufficient’ information to make informed assessments against the Part 4 Purpose should be independent of whether suppliers are subject to price-quality regulation. Accordingly the requirements for EDBs that are exempt from price-quality regulation are essentially the same as for non-exempt suppliers.<sup>22</sup>

- 2.23 We will use the disclosed information, where appropriate, in setting price-quality paths. We also propose to align definitions and categories across the different regulatory instruments. These measures are designed to minimise the costs of the regime.

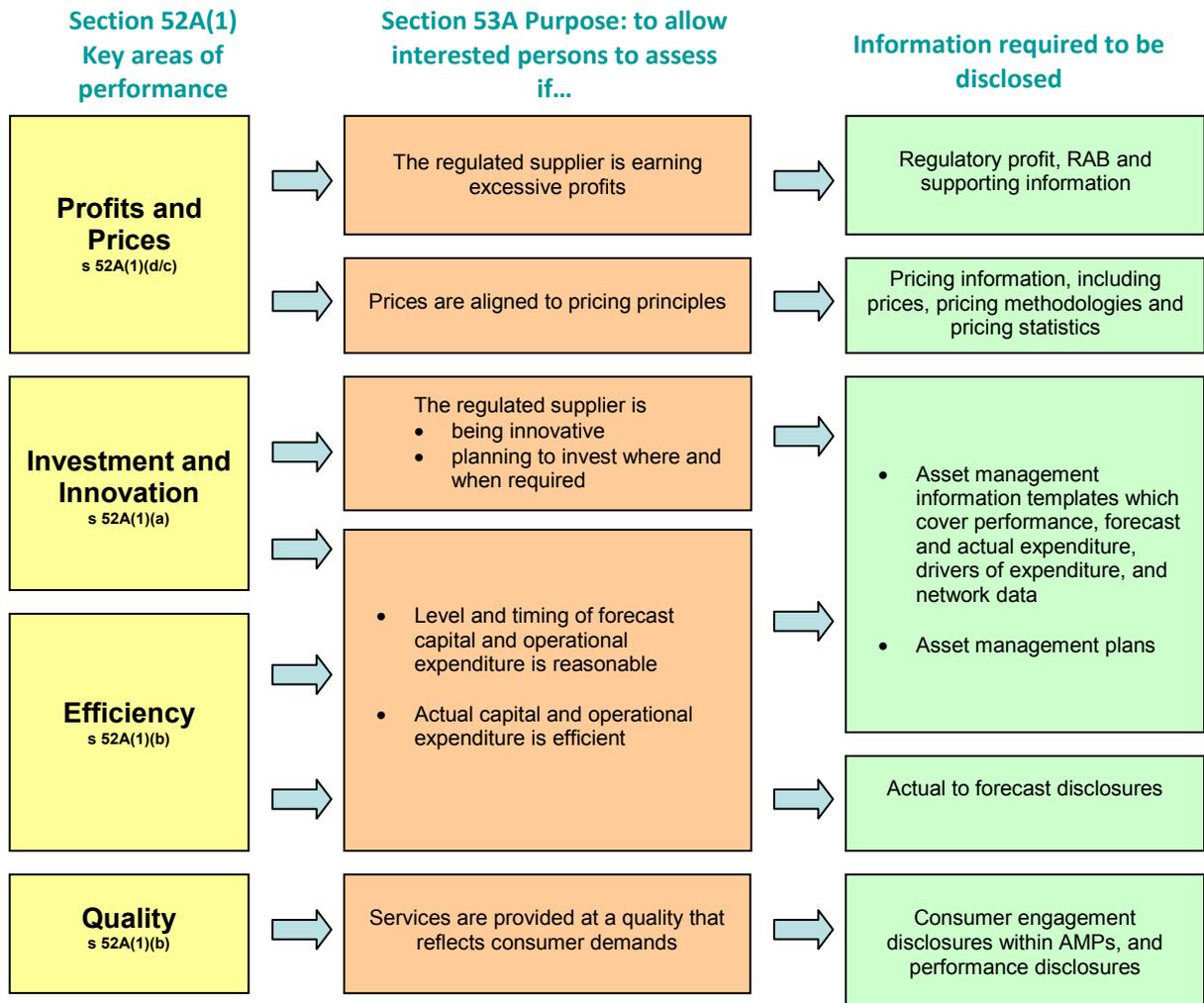
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<sup>21</sup> This is consistent with our view in the Discussion Paper of July 2009. See Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009, paragraph 53.

<sup>22</sup> Several submitters on the July 2009 Discussion paper considered that exempt and non-exempt EDBs should be treated differently under ID. Orion considered that compliance by non-exempt EDBs with the section 53N requirements of the default price path, together with disclosure of AMPs, should be sufficient for information disclosure. See Orion, *Submission on Information Disclosure Discussion Paper*, 11 September 2009. Our view above is consistent with our view as expressed in the discussion paper.

2.24 Figure 2.1 below outlines the information we consider an interested person needs to make informed assessments of whether the Part 4 Purpose is being met. The level of detail in each category, the degree of standardisation across suppliers, and the prescription of the format are key determinants of the costs of complying with the disclosure requirements. We understand the need to implement a cost-effective regulatory regime, whilst ensuring sufficient information is available to satisfy the purpose of ID – this is discussed further in paragraphs 2.34 to 2.44.

**Figure 2.1: Key areas of performance and the information to be disclosed**



*Input Methodologies and Information Disclosure*

2.25 The IMs are the relevant methodologies, processes, rules and matters applicable to a type of regulated service.<sup>23</sup> Section 52S specifies that the Commission, in deciding or determining how regulation under Part 4 should apply to regulated goods and services, must apply every relevant IM. Section 52S also requires regulated suppliers to apply every relevant IM in accordance with the relevant s 52P determination.

<sup>23</sup> See *Commerce Act, (Electricity Distribution Services Input Methodologies) Determination*, 22 December 2010; and *Commerce Act, (Gas Distribution Services Input Methodologies) Determination*, 22 December 2010; and *Commerce Act, (Gas Transmission Services Input Methodologies) Determination*, 22 December 2010.

- 2.26 Regulated suppliers that are only subject to ID regulation under Part 4 (ie, consumer-owned 'exempt' EDBs), are not required to apply IMs relating to cost of capital and pricing methodologies.<sup>24</sup> However, all suppliers may still be required to disclose information about pricing methodologies, and methodologies for evaluation or determining the cost of capital, that they do in fact use.<sup>25</sup>
- 2.27 The IMs that apply to the ID Determinations for EDBs and GPBs are:
- 2.27.1 asset valuation
  - 2.27.2 cost allocation
  - 2.27.3 treatment of taxation
  - 2.27.4 pricing methodologies (for GPBs only).
- 2.28 The application of these IMs to ID is discussed in the relevant chapters of this paper. For example, Chapter 3 discusses the IMs for cost allocation and asset valuation and the IM for GPB pricing methodologies is discussed in Chapter 5.

*Other statutory considerations - Role of the Electricity Authority*

- 2.29 Under s 54V(4) of Part 4, we must take into account a number of matters made under the Electricity Industry Act 2010 before exercising any powers or performing functions under Part 4. These matters include provisions of the Electricity Industry Participation Code 2010 (the Code) that relate to pricing methodologies, decisions of the EA under that Code, or relevant EA guidelines of which we receive advice.<sup>26</sup>
- 2.30 Suppliers encouraged us to align our requirements for the disclosure of pricing methodologies with the EA's requirements, including its pricing principles (for EDBs) and its guidelines on information disclosure.<sup>27</sup>
- 2.31 The Commission and the EA meet regularly to ensure that our workstreams are aligned and our regulatory requirements do not overlap, where practicable. This is consistent with the purpose and intent of the Memorandum of Understanding (MOU) signed by the Commission and the EA in December 2010.<sup>28</sup> The major area of

<sup>24</sup> See Commerce Act 1986, s 53F(1).

<sup>25</sup> See Commerce Act 1986, s 53F(2)(b).

<sup>26</sup> See section 54V(4)(c)-(d) of the Act. By letter of 31 October 2011, the EA advised the Commerce Commission of amendments to the Code which introduced a number of measures to provide for 'more standardisation' of electricity distribution arrangements, which was required pursuant to section 42 of the Electricity Industry Act 2010. In the Authority's view, the Code provisions likely to be of most relevance to the Commission were those: a) setting limits on the prudential requirements that electricity distribution business may include in their use-of-system agreements with retailers; and b) requiring distributors to indemnify retailers in respect of liability under the Consumer Guarantees Act 1993 for breaches of acceptable quality of supply, where those breaches were caused by events or conditions on the distributor's network, unless agreed otherwise by both parties.

<sup>27</sup> See: Commerce Commission, *Workshop 2: Pricing Disclosures 31 May 2011 - Workshop Final Minutes*, 31 May 2011.

<sup>28</sup> Among other things this MOU outlines the respective responsibilities of the Commission and the EA, for the electricity sector, and obliges the two parties to work together to take account of the activities and

commonality with the EA's responsibilities for EDBs is pricing. We discuss how we have reflected the EA's pricing principles in Chapter 5.

*Other statutory considerations - Energy efficiency*

- 2.32 Section 54Q requires that the Commission must promote incentives, and avoid imposing disincentives, for suppliers of electricity lines services to invest in energy efficiency and demand side management, and to reduce energy losses, when applying the provisions of Part 4 to electricity lines services. This is reflected in our AMP requirements where we discuss, in particular, investments to limit energy load losses.<sup>29</sup>

**2.4 Commission's general approach to determining ID requirements**

- 2.33 This section describes our approach to information disclosure for EDBs and GPBs. In particular, this section discusses:
- 2.33.1 our approach to the development of ID requirements that are cost-effective
  - 2.33.2 the process undertaken to understand the use of disclosed information by interested persons (including suppliers)
  - 2.33.3 our approach to the analysis and publication of information consistent with our statutory obligations
  - 2.33.4 how we made decisions about the sufficiency of information to be disclosed.
- 2.34 As noted in paragraph 2.24 above, the costs of complying with ID requirements are driven by the level of detail, and the degree of standardisation and format, in addition to the specific disclosures required. One of our key considerations in developing ID requirements is that they be cost-effective. This can be achieved by:
- 2.34.1 relying on existing information gathering practices and readily available data formats, where possible
  - 2.34.2 providing suppliers with flexibility, where appropriate, to present information in a manner which reflects how they manage their businesses (pricing methodologies and AMPs, for example)
  - 2.34.3 requiring information that is consistent with the requirements of other forms of regulation (such as the DPP/CPD as noted above in paragraph 2.23)
  - 2.34.4 requiring disclosure of information that is useful for suppliers in running their businesses

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responsibilities of the other party when developing regulatory requirements for the electricity sector. See *Memorandum of Understanding between the Electricity Authority and the Commerce Commission*, December 2010, available from the Commerce Commission website: [www.comcom.govt.nz](http://www.comcom.govt.nz).

<sup>29</sup> See paragraph 4.94.2.

- 2.34.5 limiting the scope of information disclosures where little apparent use is made of the information currently disclosed
  - 2.34.6 providing transitional arrangements that adjust the timing and application of provisions for some disclosure requirements for an initial period after the commencement of ID regulation under Part 4.<sup>30</sup>
- 2.35 EDBs and GPBs already prepare and publicly disclose information through existing ID requirements.<sup>31</sup> EDBs are currently subject to the Commission’s Electricity Distribution (Information Disclosure) Requirements 2008, under the (repealed) Part 4A of the Act. GPBs are subject to ID under the GIDRs, administered by the MED.<sup>32</sup>
- 2.36 As the current EDB requirements are more developed and more closely aligned with the ID regime under Part 4 than the current GPB requirements, we used the 2008 EDB requirements as a starting point for developing the draft ID Determinations. We also:
- 2.36.1 considered what changes to the existing requirements are needed in light of the new Part 4 provisions
  - 2.36.2 identified what aspects of the requirements are sector-specific, i.e. that should be different for GDBs and GTBs (and tailored the draft ID requirements for GDBs and GTBs in light of those differences)
  - 2.36.3 spoke to a range of interested persons to better understand the disclosed information they use to assess the provision of services regulated under Part 4, and to identify gaps in the available information.<sup>33</sup>
- 2.37 In considering what changes are needed in light of the new Part 4 provisions, we:
- 2.37.1 identified the matters that were not fully resolved in the 2008 review of the EDB ID requirements and were ‘held over’ until the ID requirements are set under Part 4<sup>34</sup>

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<sup>30</sup> Timing and other transitional provisions are discussed in detail in Chapter 6.

<sup>31</sup> Both sets of requirements will be superseded by the coming into force of s 52P Information Disclosure Determinations for EDBs and GPBs.

<sup>32</sup> Section 55J of the Act provides that the GIDRs continue to apply to each supplier of gas pipeline services in respect of every financial year that precedes the first financial year to which a determination made by the Commission referred to in section 55E(1) applies to that supplier.

<sup>33</sup> We have consulted a wide range of organisations including Gen-tailers (e.g. Genesis Energy, Contact Energy, Meridian), consumers and their representatives (e.g. Federated Farmers, Domestic Energy Users Network, NZ Defence Force, Fonterra), consultancies (e.g. Smartpower, Group Energy Purchase, Simply Energy), and regulators and government departments (GIC, EA, MED). We received a strong message that many interested persons do not have sufficient resources to conduct full analysis themselves or do not consider it to be their role. They see it as the Commission’s role to analyse disclosed information, and to highlight issues and findings to a wider audience. This and other key messages from this engagement were summarised in: Commerce Commission, *Information Disclosure Emerging Views Briefing Presentation*, 7 October 2011, pp.8-10.

- 2.37.2 considered whether any of the existing requirements were inconsistent with, or insufficient to meet, the purpose of ID under Part 4.
- 2.38 Under s 53B(2)(b), we have a statutory obligation to publish a summary and analysis of disclosed information for the purpose of promoting greater understanding of the performance of suppliers of individual regulated suppliers, their relative performance, and the changes in performance over time. To inform the information disclosure requirements, we have considered what information we need to analyse performance.
- 2.39 This analysis would include assessments of the key areas of performance outlined in Figure 3.1.
- 2.40 The performance of suppliers will vary due to factors which vary over time (and which may be specific to each business). Consideration of these factors, some of which are outside management's control, is necessary for interested persons to make informed assessments of whether the Part 4 Purpose is being met. Our view is that there are some gaps in the information which is currently available to enable interested persons to understand the performance of regulated suppliers over time (for suppliers individually and collectively). These gaps in information may also affect the ability to compare suppliers' relative performance.<sup>35</sup> The information gaps, and the proposed disclosure requirements necessary to fill those gaps, are discussed in particular in Chapter 4 (Asset Management Information) of this Paper.
- 2.41 We have taken practical steps to maximise the cost-effectiveness of the draft ID Determinations, including seeking input from suppliers prior to making our draft decisions. For example, we have:
- 2.41.1 held industry workshops in May and June 2011 on key areas of information disclosure<sup>36</sup>
  - 2.41.2 convened a technical reference group on asset management information to provide technical input to the draft ID Determinations.
- 2.42 Partly as a result of this engagement, as well as our own further consideration of matters, our thinking on certain issues has changed. For example,
- 2.42.1 AMPs are only required to be disclosed every two years (paragraph 4.71)
  - 2.42.2 the requirement to publicly disclose prescribed terms for non-standard contracts is simplified (limited terms and conditions of non-standard

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<sup>34</sup> The key areas held over for later review included consolidation statements, related party transactions, allocation of common costs, distributed generation, transmission bypass and pass-through costs. These are addressed in Chapter 3 of this paper.

<sup>35</sup> Section 53B(2)(b) of the Act.

<sup>36</sup> Agendas, papers, and minutes from these workshops are on our website at <http://www.comcom.govt.nz/part-4-review-of-electricity-information-disclosure-requirements/> and at <http://www.comcom.govt.nz/gas-information-disclosure/>.

contracts are required to be publicly disclosed – most are only required to be disclosed on request) (paragraph 5.47)

- 2.42.3 the draft ID Determinations do not require the disclosure of consolidation statements (paragraph 3.66).
- 2.43 As a result of this engagement and further analysis, we are confident that the information proposed under the draft ID Determinations:
  - 2.43.1 is sufficient to enable interested persons to assess whether the Part 4 Purpose is being met, and
  - 2.43.2 will be both useful and used in practice.
- 2.44 We remain open to considering further proposals which identify disclosure requirements that may impose greater costs than benefits, as well as proposals to improve the sufficiency of information in ways which impose low net costs (relative to benefits). We invite further proposals and suggestions in submissions from all interested persons.

## Chapter 3: Historical Financial Information

Description and link to Part 4 Purpose	<p>Historic financial information is needed to understand, amongst other things, whether regulated suppliers:</p> <ul style="list-style-type: none"> <li>• are limited in their ability to extract excessive profits</li> <li>• have incentives to improve efficiency</li> <li>• share the benefits of efficiency gains with consumers including through lower prices</li> <li>• have incentives to invest, including in replacement, upgraded and new assets.</li> </ul>
Main changes proposed to disclosure requirements for EDBs	<p>The historic financial information requirements are similar to the EDB requirements specified by us in 2008. The limited number of changes includes:</p> <ul style="list-style-type: none"> <li>• application of the IMs</li> <li>• a ROI calculation that takes into account the timing of cash flows</li> <li>• specification on how related party transactions can be valued.</li> </ul> <p>The draft ID Determinations do not require a consolidation statement to be disclosed.</p>
Specific changes proposed to disclosure requirements for GPBs	<p>The ID determination for GPBs will be the first time disclosure requirements have been prepared by us in accordance with the Act. The changes are significant and include:</p> <ul style="list-style-type: none"> <li>• application of the IMs</li> <li>• enhanced prescription of disclosed information, including less reliance on GAAP</li> <li>• a requirement to disclose information via templates</li> <li>• no requirement to disclose a balance sheet, cash flow statement or GAAP prescribed note disclosures</li> </ul>
Reference in draft ID Determinations	Section 2.3 and schedules 1-12 and Schedule 20 and 21 (EDBs), Schedule 20 (GDBs and GTBs)

### **3.1 Introduction**

- 3.1 This chapter sets out the reasons for our draft decisions on the disclosure of historical financial information by EDBs, GDBs and GTBs.
- 3.2 This chapter discusses:
- 3.2.1 the importance of historical financial information and why it is necessary to assess whether the purpose of Part 4 is being met (section 3.2)
  - 3.2.2 the approach to setting historical financial information requirements (section 3.3)
  - 3.2.3 the application of input methodologies to historical financial information (section 3.4)
  - 3.2.4 the approach to assessing profitability through return on investment (section 3.5)
  - 3.2.5 information for investment and efficiency assessment (section 3.6)
  - 3.2.6 how regulatory profit is determined, including the treatment of discretionary discounts and customer rebates, gain /loss on sale of assets, capital contributions and vested assets, valuation of related party transactions, self insurance expenses, merger and acquisition costs and term credit spread differential allowance (section 3.7)
  - 3.2.7 information required to support the assessments required under Part 4 (section 3.8)
  - 3.2.8 information required for the purpose of assessing compliance (section 3.9)
  - 3.2.9 transitional provisions (section 3.10)

### **3.2 The importance of historical financial information**

- 3.3 The disclosure of historical financial information assists interested persons to assess whether the performance of regulated suppliers is consistent with outcomes that are observed in workably competitive markets. In particular, the disclosure of historical financial information assists interested persons to assess whether regulated suppliers are limited in their ability to extract excessive profits, have incentives to improve efficiency, share with consumers the benefits of efficiency gains including through lower prices and have incentives to invest, including in replacement, upgraded and new assets.
- 3.4 Section 53C(2) provides for the disclosure of a range of financial information, including financial statements, asset values and valuation reports, transactions with related parties, financial and non-financial performance measures, and consolidated

information which may also include information about unregulated goods and services.<sup>37</sup>

- 3.5 An efficient firm in a workably competitive market could expect to earn normal returns (i.e. its cost of capital). The opportunity to earn normal returns over the lifetime of an investment should allow a business to preserve its ‘financial capital’ (in real terms). Such an outcome is often referred to in accounting terms as financial capital maintenance (FCM).<sup>38</sup>
- 3.6 The concept of FCM provides useful guidance in setting information disclosure requirements in respect of historical financial information, as disclosures which are consistent with the concept of FCM enable interested persons to assess the extent to which regulated supplier’s profitability levels are consistent with outcomes in a workably competitive market.<sup>39</sup>
- 3.7 Although the application of the FCM concept for the purposes of information disclosure does not, of itself, maintain financial capital, FCM provides valuable guidance in specifying how the value of the Regulatory Asset Base (RAB) is to be rolled forward, and how changes in asset value, as well as in other parameters, should be included in the measurement of ROI.
- 3.8 Financial information is also useful in assisting interested persons in assessing whether or not efficiencies are being made and incentives to invest are in place, consistent with outcomes in a workably competitive market.

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<sup>37</sup> Commerce Act 1986, s 53C(2).

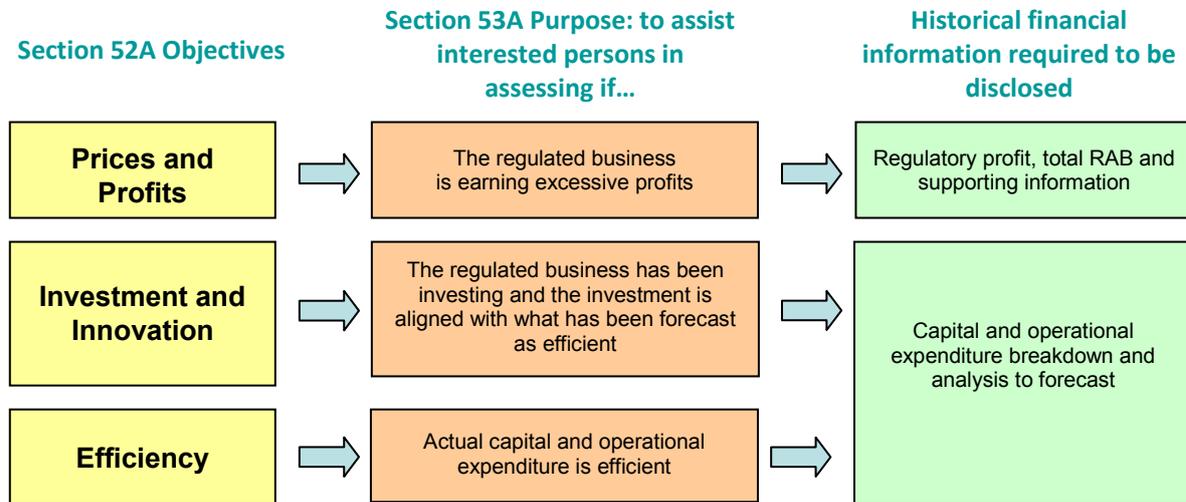
<sup>38</sup> For example: “In defining the costs of depreciation and allowed return, regulators should adopt rules that meet the accounting principle of ‘Financial Capital Maintenance’ (FCM), i.e. rules which allow investors to maintain the real value of their capital. This principle is a necessary condition for total cost recovery – meaning for efficient investment and for the prevention of monopoly profits. ... FCM therefore provides the standard by which investors effectively measure whether the regulatory regime is allowing them to recover their costs including a rate of return comparable with that offered by other companies and sectors” (Shuttleworth, G., supra n 95, pp. ii and 13). The concept of FCM underpins the decisions of regulators in many OECD countries (e.g. refer: Diewert E., Lawrence D. and Fallon J., *Asset Valuation and Productivity-Based Regulation Taking Account of Sunk Costs and Financial Capital Maintenance*, Report to the Commerce Commission, Economic Insights, Canberra, 11 June 2009, pp. 39-47).

<sup>39</sup> Further discussion on the concept of financial capital maintenance in a regulatory setting is available in Commerce Commission, *Input Methodologies Discussion Paper*, 19 June 2009, paragraphs 2.60–2.67.

### 3.3 Approach to determining financial information

3.9 Figure 3.1 outlines our approach to the disclosure of historical financial information.

**Figure 3.1: Approach to historical financial information disclosure**



- 3.10 Historical financial information (i.e., information on actual revenues and expenditure) is captured by businesses in an accounting system. Through the consistent application of rules and processes, this constitutes an integrated body of consistent information to enable an assessment of a business's financial performance. Accounting information is produced for a variety of purposes, including internal management purposes and also external statutory purposes such as reporting to external stakeholders and the tax authorities.
- 3.11 The approach to the preparation of financial information depends on the purpose for which it is prepared. For example, internal management accounting will generally be reported in accordance with the structure of management accountabilities and will generally contain a greater level of detail than is required for statutory financial reporting purposes. Accounting information prepared for external purposes is typically prepared on the general rules and principles known as 'Generally Accepted Accounting Practices' (GAAP), a term that is defined in the Financial Reporting Act 1993.
- 3.12 The purpose of regulatory reporting is distinct from other forms of external reporting. Accordingly, consideration needs to be given to the ability of GAAP reporting requirements to meet the purpose of information disclosure under Part 4. Where GAAP is not sufficient to meet the purpose of regulatory reporting, alternate requirements have to be developed. A key example of a purpose that is not met by GAAP is that regulatory reporting under Part 4 requires information to be disclosed based on a business activity, rather than an entity, basis.
- 3.13 GAAP, however, is a cost-effective means of reporting financial information, as it is well understood and is reflected in existing business systems and processes.

Accordingly, we consider that for the purposes of regulatory reporting GAAP should be the starting point. Submitters generally agreed with applying GAAP as the starting point but modifying where necessary in order to meet the purpose of information disclosure.<sup>40</sup>

- 3.14 Conversely, in some instances information required to be disclosed through GAAP may not be necessary for the purposes of regulatory reporting. Our preliminary view, as set out in the ID Discussion Paper, is that information on equity, working capital, financing and cash flow are not required for regulatory reporting purposes.<sup>41</sup>

### 3.4 Application of input methodologies

- 3.15 As discussed above, the purpose of statutory financial reporting (which is prepared in accordance with GAAP) and regulatory reporting are not necessarily aligned. In this context, the Act requires that we determine, and that regulated suppliers apply, input methodologies.<sup>42</sup>

- 3.16 The IMs required under the Act that apply to historical financial information disclosures are:

3.16.1 valuation of assets, including depreciation and treatment of revaluations

3.16.2 allocation of common costs

3.16.3 treatment of taxation.<sup>43</sup>

- 3.17 Suppliers do not have to apply methodologies for evaluating or determining the cost of capital for information disclosure purposes. However, we can use estimates of the cost of capital under the cost of capital IM to monitor and analyse information disclosed under Part 4.<sup>44</sup>

### 3.5 Assessing profitability through the return on investment approach

- 3.18 Determining whether the purpose of Part 4 is being met requires some indicator of profits to be disclosed. We are proposing that EDBs and GPs disclose an annual return on investment (ROI) indicator, presented on both a vanilla and post-tax basis, to be comparable to a vanilla WACC and post-tax WACC respectively.<sup>45</sup>

- 3.19 The standard ROI indicator is derived from the expression for an internal rate of return (IRR) calculation undertaken over a one year period. The ROI is found by solving for the discount rate that, when applied to revenue net of expenditure during

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<sup>40</sup> For example, Orion New Zealand Limited, *Submission on Information Disclosure Discussion Paper*, 11 September 2009, page 25.

<sup>41</sup> Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009, paragraph 220.

<sup>42</sup> Commerce Act 1986, s 52P.

<sup>43</sup> Commerce Act 1986, s 52T(1).

<sup>44</sup> Commerce Act 1986, s 53F.

<sup>45</sup> Vanilla WACC is where the corporate tax shield provided by debt capital is ignored in the cost of capital calculation and post-tax WACC is where the cost of debt is adjusted down by an interest tax deduction. Further discussion on Vanilla and Post-tax WACC is available in Commerce Commission, *Input Methodologies (EDBS & GPs) Reasons Paper*, 22 December 2010, paragraphs 6.7.1-6.7.2.

the year, and to the regulatory investment value at the end of the year, equates the present value of those amounts to the regulatory investment value at the beginning of the year. The regulatory investment value is the sum of the deferred tax balance (EDBs and GDBs only), and the RAB value. Section A1.2 of Attachment 1 sets out the expression and how it is derived.

- 3.20 Although an IRR calculation is typically based on cash inflow and outflows, our proposed ROI indicator is not intended to be a cash-based calculation. The ROI indicator cannot be entirely cash-based because the relevant input methodologies for information disclosure must be applied. There are a number of input methodologies which have a significant effect on the amounts and timing of regulatory income or cost items compared to their cash equivalents, notably:
- 3.20.1 the use of a deferred tax approach rather than a tax payable approach (EDBs and GDBs only)
  - 3.20.2 the recognition of income from capital contributions as a deduction from the RAB
  - 3.20.3 the recognition of capital expenditure in the RAB only once the associated assets are commissioned.
- 3.21 Revenue is received and expenditure is incurred throughout each year. Whereas the inter-year timing effects listed above are intended to be NPV-equivalent over time, using an ROI indicator that recognises revenue and expenditure as occurring at the *end* of the year (as is the case with the current ROI indicator for EDBs) consistently and materially under-estimates supplier returns, due to the time value of money.<sup>46</sup> Therefore, our proposed new annual ROI indicator for EDBs and GPBs assumes mid-year timing of revenue and expenditure items, because doing so provides a good approximation to recognising the amounts at the actual time they are incurred.
- 3.22 We recognise that in some circumstances a supplier might consider that the use of revenues and expenditure items disclosed on a monthly basis would result in a better estimation of returns than a mid-year timing assumption. Therefore, suppliers may also disclose their monthly revenues and/or costs, and also disclose an alternative ROI indicator which recognises the monthly timing of those amounts.

### **3.6 Assessing investment and efficiency**

- 3.23 Historical financial information is specified in the ID disclosure requirements in sufficient detail so that interested persons can make assessments about regulated suppliers' investment and operational efficiency. This section discusses the information required to understand forecasts with actual capital expenditure.

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<sup>46</sup> Irrespective of the approach to the recognition of revenues and expenditure the RAB value does not change.

### *Comparison of actual and forecast expenditure*

- 3.24 The disclosure of actual and forecast expenditure will help interested persons to compare planned efficiency with actual outcomes. Accordingly it is our draft decision that regulated suppliers should disclose the variance between actual operational and capital expenditure and forecasts previously disclosed pursuant to clause 1.1 of section 2.3, and schedule 7, of the draft ID Determinations.
- 3.25 The annual reconciliation of actual to forecast expenditure provides interested persons with a greater understanding of whether innovation and efficiency are being realised in suppliers' investments over time. Interested persons are able to consider the reasonableness of suppliers' forecasts, the appropriateness of pricing and investment timing, and the extent to which projects are being pre-financed.
- 3.26 It may be appropriate for actual expenditure to vary from forecast, especially where assumptions employed in the forecast are not borne out or where new information becomes available. Accordingly we have provided for regulated suppliers to demonstrate why actual expenditure has varied from forecast.
- 3.27 This comparison of forecasts with actual outcomes is an important quality control of the forecasting process. The draft ID determinations require the comparison of current disclosure year actual expenditure with the most recent forecasts for the year as well as a comparison of actual expenditure for the regulatory period to the forecasts available when price-quality paths were established.

### **3.7 Determining regulatory profits**

- 3.28 Regulatory profit represents the returns earned by the regulated supplier that are assessed against a regulated supplier's investments. This assists interested persons in the assessment of whether excess returns are being earned. Regulatory profit represents profits regulated under Part 4 rather than whole of entity profits, and also distinguishes between the treatment of returns under Part 4 and other reporting structures (such as GAAP). This section discusses how regulatory profit is determined.

### *Regulatory income*

- 3.29 Under the Act, all income associated with the supply of regulated services is regulated. However, regulatory income as disclosed in regulatory profit requires adjustments to accommodate unique characteristics of regulated services and to align with the IMs and other components of regulation. Discretionary discounts and customer rebates, revenue smoothing, gain / loss on sale of assets and capital contributions and vested assets are discussed further in this section.

### *Discretionary discounts and customer rebates for EDBs*

- 3.30 Revenues for EDBs are to be disclosed on a gross basis, ie, before the deduction of any distributions.
- 3.31 Customer owned EDBs can return profits to owners through means other than dividends, such as discretionary discounts and customer rebates. For the purposes

of determining regulatory income, these methods of returning profits are to be treated as being equivalent to dividends. This means that the distribution should not affect the disclosed regulatory profit. This would be irrespective of the way these payments are treated for accounting and tax purposes.

- 3.32 The exception to this is where a discount is included in the published ('posted') price. This is not discretionary, given that it is the published price that the consumer responds to, and should therefore form the basis of performance measures. In this case the revenue which forms part of the regulatory profit is disclosed net of the posted discount.
- 3.33 Our draft ID Determinations require that the disclosed distributions are the pre-tax amounts.<sup>47</sup>

#### *Revenue smoothing*

- 3.34 The draft ID Determinations require all regulated revenue to be recognised in the year that it is received and does not provide for the transfer of revenues between years. This is irrespective of any mechanisms provided in operating agreements or under regulation.
- 3.35 Maui Development Limited's (MDL) operating agreement includes a mechanism that provides for the return of excess revenue or recovery of under recovery of revenue that has resulted from fluctuations in demand. The draft ID Determinations require that revenue is disclosed without the effect of this mechanism.
- 3.36 The smoothing of revenue through operating and regulatory agreements has not been adjusted for in the ROI calculation. This is a factor we consider is best considered in preparing our summary and analysis.

#### *Gain / loss on sale of assets*

- 3.37 Gains and losses on the sale of an asset are, in most instances, to be recognised and disclosed as income in the calculation of the ROI.
- 3.38 The sale of an asset used to provide regulated services will typically occur at a price other than the asset's regulatory carrying value, resulting in a regulatory gain or loss on sale. This is consistent with GAAP, where the difference between the sale price of an asset and the book value is reflected as a gain or loss in income. The recognition of the gain or loss provides for the full economic benefit or cost of owning the asset to be reflected in regulatory profits.
- 3.39 The sale of an asset between regulated suppliers is, however, treated differently. Where a regulatory asset is sold to another regulated supplier, the asset base from which a return can be earned by the acquiring regulated supplier must not be

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<sup>47</sup> For a discussion on the tax effects which arise because the Inland Revenue Department (IRD) recognises rebates as a tax deductible expense, refer to the IM reasons Paper. Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, at paragraphs G2.40-G2.47.

affected by the price.<sup>48</sup> As such, if the sale value of the asset is not recognised in the RAB of the acquiring regulated supplier then it would be inconsistent with the concept of FCM for the selling regulated supplier to recognise the gain or loss on sale.

- 3.40 The sale of an asset between regulated and unregulated business units has a separate treatment as well. Any asset transfers between regulated and unregulated business units within the same entity are notional as there is no actual transfer of title. Accordingly, the value at which the asset is transferred is open to manipulation, which in turn can create a transfer of wealth between the regulated supplier and its customers. To address this concern such assets are deemed to have been disposed of at their regulatory carrying value, which results in there being no gain or loss on disposal. Requirements for the disclosure of transactions with related parties and between regulated and unregulated parts of the business are discussed later in this chapter.

#### *Capital contributions and vested assets*

- 3.41 To be consistent with the IM determinations and the FCM principle – but differing from GAAP - capital contributions and vested assets are not recognised as income for regulatory purposes.
- 3.42 Capital contributions are contributions received from a customer or another third party for the purpose of constructing or enhancing an asset that is included in the RAB. Vested assets are those assets which are constructed by a third party, and are subsequently transferred to the regulated supplier who then takes ownership and responsibility for those assets. Vested assets may be transferred for no consideration or for partial consideration.
- 3.43 As discussed in the IMs Reasons Paper, vested assets are to be included at the cost to the regulated supplier. Where a regulated supplier has received a capital contribution, the value of the commissioned asset is recognised in the RAB net of the capital contribution.<sup>49</sup>
- 3.44 Adopting the ‘net approach’ avoids volatility in disclosed ROIs that occurs with treating capital contributions or vested assets as income. Under the ‘net approach’ the effect of capital contributions is spread over the remaining life of the asset and should be NPV-equivalent to the ‘income approach’ over the life of the asset.

#### *Expenses*

- 3.45 For interested persons to be able to make an informed assessment of regulatory profits, the disclosed expenses need to be aligned with the treatment of regulatory income and the RAB.

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<sup>48</sup> The concept of FCM provides for a normal return over the lifetime of the regulated assets, irrespective of whether the asset is sold or transferred between regulated suppliers.

<sup>49</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, E7.1-E7.5.

- 3.46 The IMs outline the approaches to depreciation, revaluations, allocation of common costs and treatment of taxation. The approaches to these regulatory expenses are explained in the IM's Reasons Paper.<sup>50</sup> The valuation of assets section of the IM also determines what costs can be recognised as assets.<sup>51</sup>
- 3.47 Valuation of related party transactions, self insurance, merger and acquisition costs and term credit spread differential are discussed further in the following sections.

#### *Valuation of related party transactions*

- 3.48 The draft ID Determinations require related party transactions to be valued based on, or linked to, specified objective and verifiable information. This helps demonstrate that the transaction prices approximate what could be expected in arm's length transactions (in workably competitive markets). As a result, the disclosed transaction value may differ from the actual transaction value.
- 3.49 This requirement represents a change in approach to related party transactions when compared against the current EDB ID requirements. The change in approach is necessary as parties which are related to each other may have different incentives when setting the terms and conditions of transactions than parties which are not related. The terms (especially price) and conditions agreed between the related parties can influence the information disclosed by the regulated entity, which can in turn hinder interested persons' ability to assess profitability. For this reason, different considerations apply to the disclosure of related party transactions, as compared to other transaction values.
- 3.50 Section A1.4 of Attachment 1 outlines the reasons and approach to determining the value of related party transactions. That attachment also discusses proposed amendments to the Asset Valuation IM regarding the value of assets acquired from a related party.<sup>52</sup>

#### *Self insurance*

- 3.51 At this point, we propose only allowing self-insurance costs approved through a CPP to be recognised as an expense in regulatory profit. As part of our current consultation on additional input methodologies for DPPs, we are considering our approach to insurance costs under a DPP further.<sup>53</sup> We will reconsider the treatment of self-insurance as outlined in the draft ID requirements in light of submissions on that consultation paper. Those submissions are due by 27 January 2012.

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<sup>50</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, chapters 3, 4 and 5.

<sup>51</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, clause 2.2.11.

<sup>52</sup> See paragraphs A1.55-A1.57.

<sup>53</sup> Further discussion on self insurance is available in Commerce Commission, *Additional Input Methodologies for Default Price-Quality Paths Process and Issues Paper*, 9 December 2011, paragraph 157 – 161.

### *Merger and acquisition costs*

- 3.52 Merger and acquisition costs, to the extent the merger or acquisition would benefit the regulated service in question, are to be recognised as regulatory costs. Recognition is subject to the disclosure of the expected merger and acquisition benefits to the regulated service.
- 3.53 The recognition of merger and acquisition costs in regulatory profits allows costs to be matched with benefits. The recognition allows interested persons to understand the full cost of providing the regulated service, including costs incurred for the purpose of benefiting consumers through such things as efficiency gains.
- 3.54 Merger and acquisition expenses tend to be irregular, but may be substantial when they occur. Accordingly, for interested person to have sufficient information to assess profits and expenditure, merger and acquisitions costs are required to be separately disclosed.

### *Term credit spread differential*

- 3.55 Regulated suppliers can where applicable recognise an allowance for a long term credit spread differential.
- 3.56 A firm with long term debt may incur a credit spread that, due to the long maturity of that debt, is greater than what is assumed in the WACC.<sup>54</sup> This greater cost is known as the term credit spread differential.
- 3.57 The term credit spread differential allows regulated suppliers to recognise the greater credit spread on long term debt as an expense in regulatory profit.<sup>55</sup> Further reasoning for recognising a term credit spread differential allowance is outlined in the IM Reasons Paper.<sup>56</sup>

## **3.8 Interested persons' understanding of performance**

- 3.58 For interested persons to determine whether the purpose of Part 4 is being met, an understanding is required of what has occurred during the year, and how reporting requirements may have affected reported results. As discussed in relation to the ROI, in assessing whether the purpose of Part 4 is being met performance indicators are simply a guide to underlying performance and supporting information is required to enable an appropriate assessment.
- 3.59 Some of the key areas where the draft ID Determinations provide additional information for understanding performance are:

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<sup>54</sup> The cost of capital IM estimates a debt premium based on a term of five years, but some firms may have debt with a longer term.

<sup>55</sup> It also re-adjusts the allowance for debt issuance costs and allows for the cost of entering an interest rate swap. Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraphs 6.3.27-6.3.35, and Appendix H6.

<sup>56</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraphs 6.3.27-6.3.35, and Appendix H6.

- 3.59.1 net and gross line charge revenue for EDBs, so that interested persons can understand performance pre and post discretionary discounts and customer rebates
  - 3.59.2 gain / (loss) on sale of assets, so interested persons can remove any resulting volatility in regulatory profit
  - 3.59.3 information supporting the application of the cost allocation IM, to assist with performance assessments
  - 3.59.4 incremental rolling incentive scheme, so interested persons can understand how efficiency incentives are working
  - 3.59.5 information supporting the application of regulatory depreciation requirements, to assist with performance assessments
  - 3.59.6 regulatory asset base roll-forward and regulatory tax allowance, to assist interested persons in understanding how they are determined
  - 3.59.7 related party disclosures, so that interested persons can assess the extent to which reported performance may be influenced by related party transactions.
- 3.60 Section A1.5 of Attachment 1 provides further reasoning for the specification of certain disclosures.<sup>57</sup>

### **3.9 Disclosure to assess compliance**

- 3.61 Section 53B(1)(c) of the Act requires regulated suppliers to supply us with any statement, reports, agreements, particulars or other information required for the purpose of monitoring their compliance with the determination. Information required for this purpose is included in the draft ID Determinations. As such, the determination serve as notice for the purpose of s.53B(1)(c). Section 53D also provides for public disclosure of consolidated information for the purpose of monitoring compliance.
- 3.62 This section discusses the disclosure of cost allocation information for the purpose of monitoring compliance and outlines our draft decision on consolidated information.

#### *Cost allocation*

- 3.63 In addition to the public disclosure of cost allocation information, regulated suppliers are required to disclose additional information to us to explain how allocations have been made. This helps us to monitor compliance with the cost allocation requirements.
- 3.64 As outlined above, certain information is required to be publicly disclosed to assist interested persons in understanding how the cost allocation IM has been applied.

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<sup>57</sup> Paragraphs A1.67-A1.87.

The detail of this disclosure is limited to restrict the amount of information disclosed about unregulated services.

- 3.65 In the IMs Reasons Paper we outlined how we may require additional disclosure that relate to unregulated services that allow us to monitor compliance.<sup>58</sup> Pursuant to section 53B(1)(c) of the Act this information is required to be disclosed through Schedules 11 and 12 of the determination. Paragraphs A1.68 – A1.74 provide further discussion on the type of cost and asset allocation information required.

#### *Consolidation statements*

- 3.66 While we have previously proposed the disclosure of consolidation statements on an annual basis,<sup>59</sup> our draft decision is that consolidated information should not be required. Our draft decision recognises the ongoing cost of such disclosures, and that we can require that consolidated information be disclosed to us (for example, under s. 53B(1)(c)) from time to time, where we consider it appropriate.
- 3.67 Consolidation statements can be used to reconcile an entity's overall financial performance (as reported under GAAP) with the information disclosed under ID. Such reconciliations can provide additional assurance as to the reliability of the disclosed financial information, and to monitor compliance with information disclosure regulation applying to regulated goods or services.<sup>60</sup>
- 3.68 Submissions on the ID Discussion Paper raised concerns with the cost of preparing consolidation statements and questioned whether the benefits outweigh the costs. Similar concerns were raised at the Financial Issues workshop in June 2011.<sup>61</sup> Submitters proposed that the verification requirements, including director certification and audit, provided sufficient monitoring of disclosed information. Submitters considered the disclosure of consolidated information would provide little additional benefit.<sup>62</sup>
- 3.69 We consider the cost of preparing consolidated information is high where:
- 3.69.1 information prepared for regulatory purposes is on a different basis than general purpose financial statements. This is particularly the case for most of the RAB information and regulatory tax which are based on regulatory requirements rather than aligned to GAAP.

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<sup>58</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, Appendix D, paragraph D5.1.

<sup>59</sup> Commerce Commission, *Information Disclosure Regulation Electricity Lines Services and Gas Pipeline Services, Process and Issues Paper*, 23 February 2011, paragraphs 35-37.

<sup>60</sup> Commerce Act 1986, s 53D.

<sup>61</sup> Commerce Commission, *Workshop 3: Financial Disclosures, Workshop Minutes*, 10 June 2011, paragraphs 20-21.

<sup>62</sup> Electricity Network Association, *Submission on Information Disclosure for Electricity Distribution Businesses*, 11 September 2009, page 11 and Powerco, *Information Disclosure Discussion Paper*, 11 September 2009, paragraph 35.

3.69.2 EDBs and GPBs, in some instances, also have different regulatory disclosure year-ends than their general purpose financial statements. This complicates and increases the cost of preparing consolidated information.

3.70 Although our draft decision is that consolidated information should not be required we are interested in receiving submissions on the costs and benefits interested persons may see in disclosing consolidation statements.

### 3.10 Transitional provisions

3.71 Transitional provisions included in the draft ID determination provide for disclosures on the establishment of the initial RAB, other balances that that require roll forward, and also to allow regulated suppliers sufficient time to establish systems to collect information that has not previously been collected.

#### *Initial RAB disclosures*

3.72 In implementing the asset valuation IM, some adjustments have been made to regulated suppliers' asset values compared to the values that have been previously disclosed. The adjustments include:

3.72.1 allowing amendments to asset values where the asset valuation IM provides for the revaluation of assets under certain circumstances (asset adjustment process)<sup>63</sup>

3.72.2 adjustments to the total RAB value for assets excluded under the IM and for the application of the cost allocation IM.<sup>64</sup>

3.73 In accordance with clause 2.2.1 of each of the IM Determinations, if a regulated supplier elects to amend asset values as part of the asset adjustment process, it is required to provide a report from an independent engineer supporting the adjustment.<sup>65</sup>

3.74 Non-exempt EDBs<sup>66</sup> and GPBs have already had the opportunity to apply the asset adjustment process pursuant to the Section 53ZD notice for starting price adjustments.<sup>67</sup> The draft ID Determinations require the disclosure of the same information as that required under the starting price adjustment notice. If an EDB has already disclosed information to us relating to the asset adjustment process the disclosures must be consistent.<sup>68</sup>

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<sup>63</sup> Under clause 2.2.1 of each of the IM Determinations.

<sup>64</sup> See part 1, subpart 1 and clauses 2.2.2 and 2.2.3 of each of the IM Determinations.

<sup>65</sup> The information requirements for the engineer's report are set out in Appendix B of the draft EDB ID determination. These include references to the ODV Handbook which will be incorporated by reference under Schedule 5 of the Act.

<sup>66</sup> Non-exempt EDBs are EDBs that are not consumer –owned and are subject to price-quality regulation pursuant to section 54(1)(b) of the Act.

<sup>67</sup> Commerce Commission, *Notice to Supply Information to the Commerce Commission Section 53ZD of the Commerce Act 1986*, 16 March 2011 and Commerce Commission, *Notice to Supply Information to the Commerce Commission Section 53ZD of the Commerce Act 1986*, 6 July 2011.

<sup>68</sup> See clause 2.10(3) of each of the draft ID Determinations.

*Roll forward of balances*

- 3.75 The initial disclosure year, being the year ended 2012, is not aligned with the start of the regulatory regime which is specified as the end of the 2009 year under previous disclosure requirements. Schedule 21 (for EDBs) and Schedule 20 (for GPBs) provides for the roll forward of these balances to the start of the initial disclosure year.
- 3.76 GPBs also require a partial year roll-forward that aligns the previous disclosure years to a September year end that has been proposed. The change in disclosure year end is discussed further at paragraphs 6.52-6.59.

*System establishment*

- 3.77 The draft ID Determinations also provide transitional provisions to allow the establishment of systems to collect information. Our draft decision is that the ID determination will be finalised in May 2012. For EDBs this is after the end of the initial disclosure year (which ends in March 2012); for GPBs this is part way through the 2012 disclosure year (which ends in September 2012). Where systems are required to collect information and the information has not previously been collected in the required manner, transitional provisions have been established, especially where the cost of collecting the information for that initial disclosure year is considered to be high.
- 3.78 In this respect, the affected areas are:
- 3.78.1 Previous year ROI disclosures
  - 3.78.2 Roll forward information relating to the RAB and tax balances for the period between the start of the regulatory regime and the initial disclosure year
  - 3.78.3 Operational and capital expenditure categories disclosure included in the Report on Expenditure, Report on Expenditure Forecasts and cost allocation disclosures.
- 3.79 Section 2.10 of each draft ID Determination outlines the proposed transitional provisions.

## Chapter 4: Disclosure of Asset Management Information

<p>Description and link to Part 4 Purpose</p>	<p>Asset management information is needed to understand whether:</p> <ul style="list-style-type: none"> <li>• assets are being managed for the long-term benefit of consumers</li> <li>• efficient investment is incurring</li> <li>• efficiency gains are being made</li> <li>• services are of a quality that reflects consumer demands.</li> </ul>
<p>Main changes proposed to disclosure requirements for EDBs and GPBs</p>	<p>While the information currently provided in EDB AMPs is extensive, we consider that a number of refinements to the disclosures are required. In particular:</p> <ul style="list-style-type: none"> <li>• new asset management (AM) templates will capture information on network data, network performance, network expenditure and the drivers of expenditure for EDBs and GPBs. The proposed templates cover both historic (disclosed 5 months after the end of each disclosure year) and prospective or other asset management plan information (disclosed in or with the AMP before the start of each disclosure year).</li> <li>• the templates are standardised, to help ensure that the disclosed information is consistent over time and between suppliers. This will allow interested persons to better understand the information disclosed.</li> <li>• GPBs and EDBs will disclose an asset management plan (AMP) at least every 2 years, with an AMP Update disclosed in the intervening years to update interested persons on any material changes to the previously disclosed AMP.</li> <li>• regulated suppliers will undertake an asset management maturity assessment (AMMAT) and</li> </ul>

	<p>disclose the result in their AMP.</p> <ul style="list-style-type: none"> <li>network, performance and pricing disclosures are to be made for each sub-network. This replaces the previous MP1 and MP3 disclosure requirements.<sup>69</sup></li> </ul> <p>The current AMP requirements will be extended in some areas for EDBs and GPBs including:</p> <ul style="list-style-type: none"> <li>planning for high impact, low probability events</li> <li>investments to reduce energy losses (for EDBs only)</li> </ul>
Specific changes proposed to disclosure requirements for GPBs	<p>In addition to the main changes outlined above, there are additional specific disclosure requirements proposed for GPBs, including:</p> <ul style="list-style-type: none"> <li>GTBs to disclose pipeline capacity headroom information (numerical factor) based on a 1-in-20 year high demand profile</li> <li>GDBs to use pressure metrics to disclose their historic and forecast pipeline capacity utilisation</li> <li>The AMP disclosure requirements specifically allow for demand scenarios in network planning</li> <li>Powerco and Vector's GDBs will disclose sub-network (previously 'non-contiguous network') information for 2 sub-networks. There is no requirement for disclosure of sub-network information by GTBs or GasNet.</li> </ul>
Reference in draft ID Determinations	Section 2.5 and schedules 14-19 (EDBs), 14-19 (GDBs & GTBs)

#### 4.1 Introduction

4.1 This chapter sets out the reasons for our draft decisions on the disclosure of asset management information by suppliers of EDBs, GDBs and GTBs.

4.2 This chapter discusses:

4.2.1 the purpose of disclosing asset management data (section 4.2)

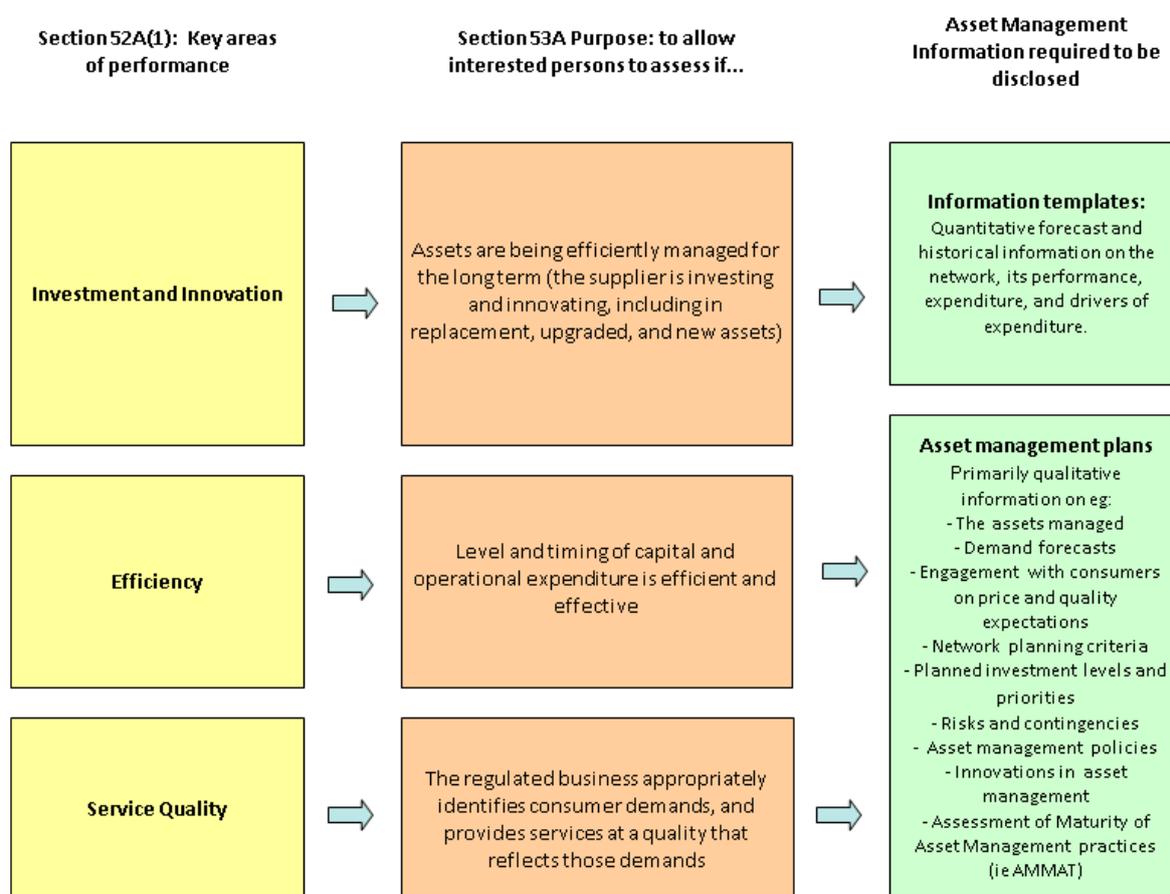
<sup>69</sup> See, Commerce Commission, *Electricity Distribution (Information Disclosure) Requirements 2008*, 31 October 2008, schedules 9 and 11. MP1 (schedule 9) covers network information; while MP3 (schedule 11) covers price and quality measures.

- 4.2.2 the data required to assess whether the purpose of Part 4 is being met (section 4.3), the current information gaps (section 4.4), how these gaps are to be closed (section 4.5), and the proposed information templates (section 4.6)
- 4.2.3 the disclosure of Asset Management Plans (AMPs), including disclosure frequency and the scope of AMP reviews (section 4.7), AMPs for GPBs (section 4.8), the AMMAT (Section 4.9) and miscellaneous changes to the current AMP requirements (section 4.10)
- 4.2.4 the definition of sub-networks (section 4.11)
- 4.2.5 disclosures for assessing the capacity of gas pipelines (section 4.12)
- 4.2.6 transitional arrangements (section 4.13).

## **4.2 Purpose – the importance of asset management information**

- 4.3 Asset management information is required to enable interested persons to assess whether regulated suppliers are managing their assets in ways which promote the long term benefit of consumers. In particular, whether the management of assets is achieving outcomes consistent with those in workably competitive markets such that suppliers:
  - 4.3.1 are investing and innovating, including renewing, upgrading and replacing their assets
  - 4.3.2 are using those assets to provide services at a quality that reflects consumer demands
  - 4.3.3 are making efficiencies in the management of their assets, and sharing those efficiencies with consumers.
- 4.4 The condition, suitability, and performance of a supplier’s assets and the way each supplier manages and invests in its assets are critical determinants of the price, cost and quality of services that consumers receive from regulated suppliers.
- 4.5 Figure 4.1 below shows the link between the key areas of performance expected in workably competitive markets and the asset management information included in the draft determination to enable an assessment of performance against these outcomes.

**Figure 4.1: Information and purpose — asset management information disclosures**



4.6 The information required to be disclosed is also consistent with Section 53C(2) of the Act which provides that information disclosed includes, without limitation:

4.6.1 plans and forecasts, including plans and forecasts about demand, investments, quality and service levels, capacity and spare capacity, and efficiency improvements

4.6.2 asset management plans

4.6.3 quality performance measures and statistics

4.6.4 assumptions, policies, and methodologies used or applied in these or other areas.

4.7 Historically, our asset management information disclosure requirements for EDBs have required AMPs to be disclosed each year, with detailed content requirements, and limited quantitative data. GPB AMPs have not been previously required to be disclosed and we have not yet set information disclosure requirements for GPBs.

4.8 The quality and compliance with the expected content of the disclosed EDB AMPs has progressively improved, driven in part by improved asset management practices.

The Commission has undertaken reviews of the AMPs,<sup>70</sup> and we consider that the gains (for EDBs in particular) from these reviews continuing to focus mainly on compliance might be limited. We recognise that there is a large amount of information contained in the AMPs and are concerned that the quantitative information that they provide is not consistently in an accessible or useful format that helps interested persons to assess whether the purpose of Part 4 is being met.

- 4.9 Our focus now is on moving to more substantive analysis of asset management information, including that currently included in AMPs, to enable interested persons to assess whether the Part 4 Purpose is met. This may include assessing:
- 4.9.1 the extent to which suppliers are managing their assets for the long term benefit of consumers. This includes understanding whether assets are being appropriately maintained, upgraded and replaced, and how a supplier is investing and responding to changes in demand and consumer needs
  - 4.9.2 whether the required level of performance demanded by consumers is being delivered
  - 4.9.3 whether asset management costs are efficient, expenditure is effective, and efficiencies in asset management are being achieved.
- 4.10 The type of asset management information required to make such assessments is discussed in the next section. While some of the information necessary to assess performance in managing assets is already currently disclosed, this information is not sufficiently available, standardised or disaggregated to enable informed analysis.

### 4.3 Types of information needed to assess performance

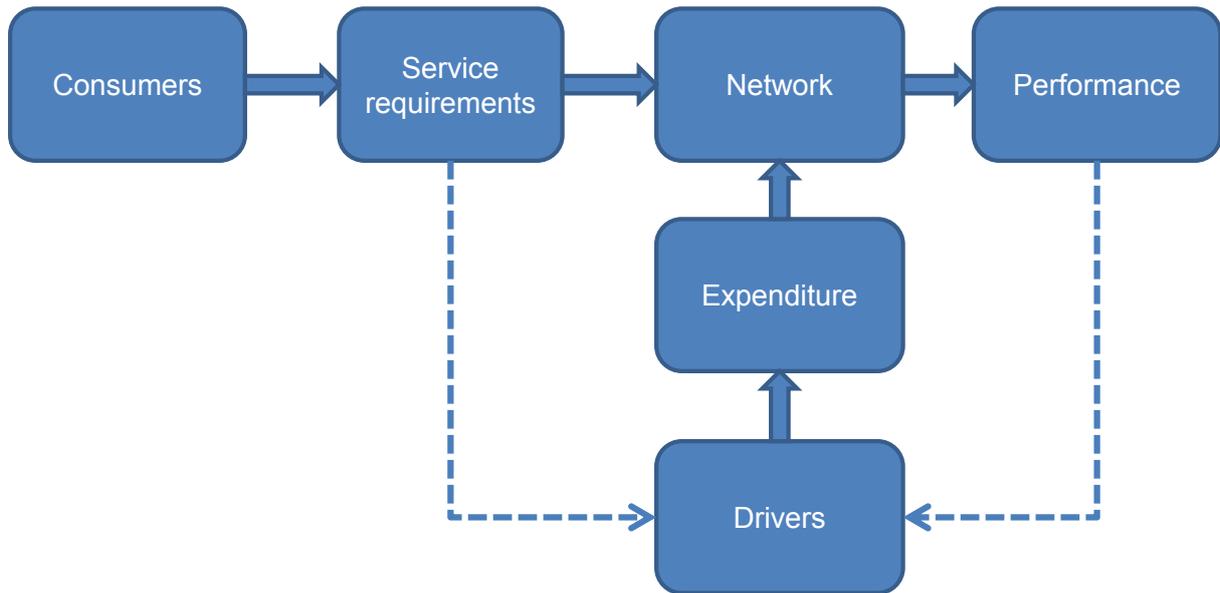
- 4.11 Figure 4.2 below summarises the relationship between consumers, their service expectations and the management of the network to deliver services to consumers. The mismatch, or gap, between the level of network performance and consumers' service requirements (identified by the dotted lines) is the main driver of future expenditure on the network.<sup>71</sup> Future network performance is shaped by expenditure on the network.

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<sup>70</sup> These compliance reviews are available on our website at <http://www.comcom.govt.nz/review-of-asset-management-plans/>. The most recent compliance review was undertaken in 2011. See Parsons Brinckerhoff New Zealand, *2011 Asset Management Plan Reviews*, 26 August 2011.

<sup>71</sup> External factors, such as resource management and health and safety legislation, may also drive network expenditure.

**Figure 4.2: Consumers, service requirements and the management of assets to deliver services to consumers**



4.12 Asset management disclosures contain information on those aspects of the relationship between consumer service requirements and performance which relate to the assets owned and managed by the regulated business:

4.12.1 The physical network (Network)

4.12.2 Expenditure on the network (Expenditure)

4.12.3 Drivers of expenditure (Drivers)

4.12.4 Network performance (Performance).

4.13 Sufficient information on each of these components is necessary to assess investment and innovation, what efficiency gains are being made, and whether services are of a quality that reflects consumer demands. In short, whether assets are being managed for the long term benefit of consumers. Section 4.6 discusses each of the components (network, expenditure, drivers, and performance) in more detail.

4.14 We now discuss the gaps in the information available under ID regulation as it currently applies to EDBs and GDBs, and why the currently available information is not sufficient to enable an assessment of whether the Part 4 Purpose is being met.

#### **4.4 Gaps in currently available asset management information**

4.15 In this section, we consider available information for GPBs and for EDBs.

##### *Gaps in the current asset management information disclosed by GPBs*

4.16 The current asset management information disclosure requirements for GPBs under the GIDRs do not require an asset management plan. While they contain some information on the pipeline(s), there is minimal information concerning age and

condition, performance, the risks to performance, and proposed investments. There is also no requirement for a supplier to disclose information about how they engage with consumers on price and service quality expectations as this may influence asset management and investment.

- 4.17 Reissuing the GIDRs under Part 4 of the Act, without overhauling those requirements, would not provide interested persons with sufficient available information to assess whether the purpose of Part 4 is being met.

*Gaps in the current asset management information disclosed by EDBs*

- 4.18 The current requirements for EDBs are more extensive than for GPBs. For example, EDBs are currently required to disclose an AMP and other information relevant to asset management, such as network information (report MP1 of the current EDB ID requirements) and price and quality measures (MP3).<sup>72</sup>
- 4.19 The current AMP and other information disclosures include some valuable quantitative asset management information. However, we consider that this information is not sufficient to assess whether the purpose of Part 4 is being met, in regard to the management of assets, for the reasons outlined below.
- 4.20 First, some of the information provided in the EDB AMPs may vary over time as the focus of the AMP changes. Specific information can be difficult to find, or may not be included (or consistently included). Quantitative information is often not in a readily accessible format. The consistent disclosure of data assists interested persons to assess performance of regulated suppliers, including whether they are managing their assets for the long term benefit of consumers. Network performance can be affected by a number of factors, including consumer requirements, consumer growth and the location, age, and condition of the suppliers' assets. Some of these factors are outside management control and change over time. Sufficient and consistent information of this type is needed to appropriately and fairly assess each supplier's performance, and to assess whether the purpose of Part 4 is being met.
- 4.21 Efficiency is one of a number of areas of performance we consider should be assessed to see if the purpose of Part 4 is being met.<sup>73</sup> We recently published a discussion paper on assessing cost efficiency, and a limited case study using information relevant to cost efficiency currently disclosed by EDBs.<sup>74,75</sup> The case

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<sup>72</sup> Commerce Commission, *Electricity Distribution (Information Disclosure) Requirements 2008*, 31 October 2008, schedules 9 and 11.

<sup>73</sup> Other areas include quality, prices and revenues, profitability, and investment and innovation. See Figure 2.1 above.

<sup>74</sup> Commerce Commission, *Information Disclosure Emerging Views Presentation*, 7 October 2011, pp.42-53. Commerce Commission, *Information Disclosure: Approaches for Understanding EDB and GPB Cost Efficiency - Technical Paper for Consultation*, 7 October 2011.

<sup>75</sup> This generated a considerable number of submissions. We propose to publish a paper and seek submissions on our approach to summary and analysis. Without pre-empting the content of that paper, we note that assessing cost efficiency is just one aspect of performance which can be assessed, and econometric techniques are just one of the available types of analysis. Our draft ID Determinations do not seek the disclosure of information for the purpose of developing econometric models to compare performance between suppliers.

study observed significant differences in apparent cost efficiency between EDBs, which could not readily be explained by the information currently disclosed under information disclosure regulation.

- 4.22 Second, definitions used when disclosing data in AMPs (and the data itself) vary across suppliers. This, together with the number of EDBs in particular, makes it difficult to confidently interpret the data and assess the performance of individual suppliers, sectors, or part of a sector (eg, exempt EDBs) over time.<sup>76</sup> Greater standardisation of data and definitions helps interested persons to assess performance, and whether the Part 4 Purpose is being met.
- 4.23 Third, much of the disclosed data is not sufficiently disaggregated to enable an interested person to assess whether the purpose of Part 4 is being met. For example, understanding performance risks and investment requirements caused by asset age or condition requires a disaggregation of asset information between asset classes and asset categories, as the condition or age of some network components (eg, power poles) can vary significantly to other components (eg, transformers).
- 4.24 Similarly, quality information (e.g. supply interruption data) is currently not disaggregated (for example, by feeder or network component). As a result, interested persons are unable to assess patterns in interruptions and the corresponding need for investment.
- 4.25 In summary, while some of the information necessary to assess performance in managing assets is currently disclosed, this information is not sufficiently available, standardised or disaggregated to enable informed analysis.

#### **4.5 Closing the gaps in asset management information disclosures**

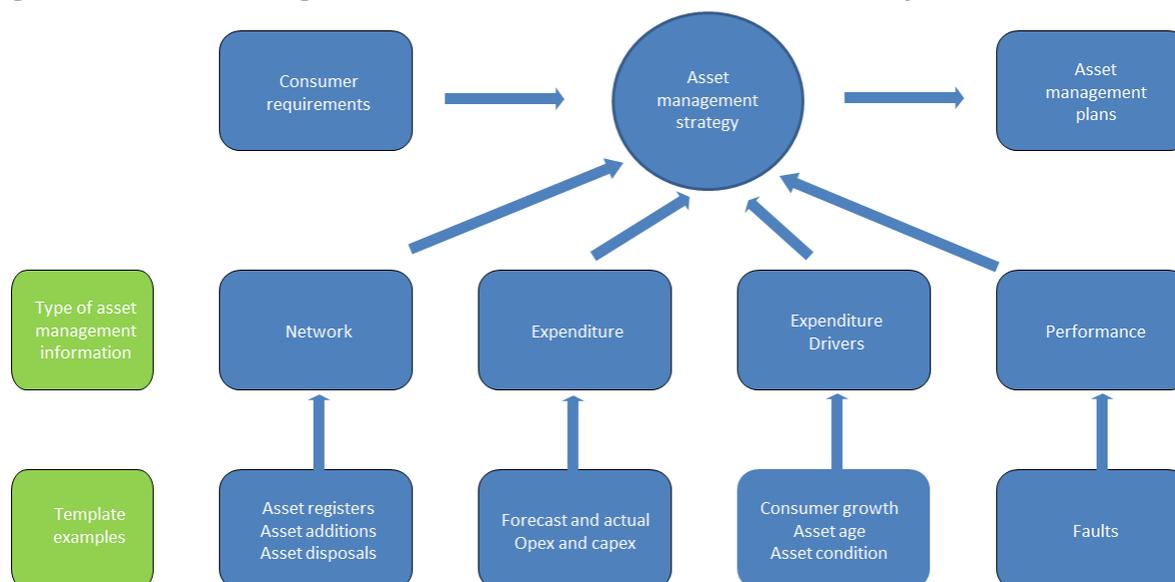
- 4.26 To address the gaps in asset management information outlined in the previous section, we propose that:
- 4.26.1 GPBs disclose an AMP. This is discussed below in section 4.8.<sup>77</sup>
- 4.26.2 all suppliers should complete asset management information templates, based on consistent formats and definitions for each service. These templates are discussed immediately below and are set out as Schedules 6-7, 14-16, 18-19 of the draft ID Determinations for all services.
- 4.27 The standardised asset management information templates seek mainly quantitative information, categorised by the four main types of management information identified in paragraph 4.12. Examples of the nature of the templates that fit into each category are shown in Figure 4.3. The templates capture information that is a key input into the supplier's asset management strategy, and which is in turn documented in the AMP.

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<sup>76</sup> As an example, suppliers take different approaches in determining what costs are disclosed in each category of operating and capital expenditure.

<sup>77</sup> Paragraphs 4.78-4.83.

**Figure 4.3: Asset management information and the information templates**



4.28 These templates (included as schedules in the draft ID Determination) are intended to enable interested persons to explore and assess the links between the network, expenditure, drivers for expenditure and network performance to assess whether the outcomes observed are consistent with those in workably competitive markets.

4.29 The templates have been tailored for each of the regulated services: gas transmission, gas distribution, and electricity distribution.

4.30 In considering the appropriate level of disaggregation for these templates we have been guided by the following principles:

4.30.1 we should not seek disclosure of information that we do not consider a company applying good industry practice would have available (or would seek to have available) to ensure its asset management practices are effective

4.30.2 we should not seek the disclosure of information solely for the purpose of comparing performance between suppliers<sup>78</sup> and to be used as inputs into complex econometric models of supplier or sector performance

4.30.3 disaggregated information should be required only where it is necessary:

- (a) to identify the drivers of expenditure
- (b) to provide information which would not otherwise be disclosed on a significant item

<sup>78</sup> One exception is the proposed requirement to disclose information on length of line affected by vegetation management (refer paragraph 4.51.2). This information was identified by one supplier as being potentially useful information (see Powernet, *Approach for Understanding EDB and GPB Cost Efficiency*, 11 November 2011, paragraph 7.3).

- (c) to inform the assessment of a company's performance over time

4.30.4 disaggregation should be based, wherever possible, on a consistent hierarchy (see, for example, Figure 4.4 below) to ensure information can be compared across networks, expenditure drivers, expenditure, and performance data.

*Benefits and cost of the information in the templates*

4.31 We expect that disclosing this additional information will:

4.31.1 generate significant long term benefits to consumers, for example by strengthening the focus on efficiency in regulated services and encouraging regulated suppliers to identify and share best practices in asset management. Analysis of this type of information has delivered significant benefits in overseas jurisdictions for regulatory price-setting purposes and could deliver significant benefits under ID regulation<sup>79</sup>

4.31.2 help a range of interested persons to better understand performance and strengthen incentives to improve performance

4.31.3 lead to improvements in governance and engagement with consumers. In particular, it will provide consumers with better information on suppliers' expenditure to enable an assessment of whether this is consistent with consumers' expectations and needs

4.31.4 improve transparency of the performance and future investment requirements of regulated services to interested persons

4.31.5 improve transparency of the performance of key regulated infrastructural services, supporting broader moves (for example, by Treasury's National Infrastructure Unit<sup>80</sup>) to improve transparency of the management of infrastructural assets generally.

4.32 Enhanced disclosures may indirectly reduce (but cannot eliminate) the risk of failures, and improve emergency response and contingency plans. Poor asset management can impose significant costs on consumers. Recent events, such as the Christchurch earthquake and the Maui pipeline shutdown, have highlighted the potentially significant economic cost when key infrastructural assets are damaged or fail, and the importance of having appropriate risk management policies in place.

4.33 We acknowledge that requiring the completion of templates that seek detailed information in prescribed formats with prescribed definitions (both of which are necessary to ensure consistency) may impose an additional cost on suppliers. This is

<sup>79</sup> The use of comparative benchmarking on efficiency in order to set starting prices, rates of change, quality standards, among other things, is prohibited under s. 53P(10) of the Act.

<sup>80</sup> See for example the National Infrastructure plan at page 51. New Zealand Government, *National Infrastructure Plan 2011*, 4 July 2011 available at [www.infrastructure.govt.nz/plan/2011](http://www.infrastructure.govt.nz/plan/2011).

the case even though similar information (though not to the same level of detail and prescribed standardisation) may be included in an AMP.

- 4.34 To mitigate the additional cost, we have sought to engage with suppliers on this proposal with an intention of aligning the information required with the information a supplier uses, or intends to use, in managing its own business.
- 4.35 We sought practical input from a Technical Reference Group (comprising industry representatives from a range of small and large suppliers of gas distribution, gas transmission and electricity distribution services) before the draft requirements were prepared and issued for formal submissions.<sup>81</sup> For example, the asset categories in the draft ID Determinations largely reflect the proposals made by nominated industry representatives from the Technical Reference Group.
- 4.36 Our aim was to limit unnecessary additional cost, and enhance the usefulness of the information to suppliers (for example, as potential benchmarking information). In addition, we:
- 4.36.1 have proposed requirements which we consider are the minimum necessary to allow an effective assessment as to whether the purpose of Part 4 is being met<sup>82</sup>
- 4.36.2 recognise that some suppliers may have difficulty in comprehensively completing all of the templates immediately, and that doing so may cause significant cost. Accordingly we will allow:
- (a) transition periods (until 2015 in some instances) in which suppliers may provide a “not available” response in some information templates if that information is not currently collected
- (b) For some information (on asset health) suppliers may disclose estimated values tagged with an assessment of their accuracy.
- 4.36.3 propose further engagement with interested persons in March-April 2012, particularly with respect to the proposed definitions to be included within the templates, before the templates are finalised. This is to ensure the asset management definitions reflect, where possible, standards and practices and approaches used, or contemplated, by regulated suppliers.<sup>83</sup>

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<sup>81</sup> Details of the Technical Reference Group, and its role are set out in our Emerging Views briefing. Commerce Commission, *Information Disclosure Emerging Views Briefing Presentation*, 7 October 2011, pp.56-59. Minutes from the Technical Reference Group meeting have been released on our website with this paper. See, Commerce Commission, *Information Disclosure Technical Reference Group Meeting (31 October to 1 November 2011)*.

<sup>82</sup> We observe in passing that they are considerably less detailed and are less onerous than those already used by economic regulators in other jurisdictions, notably the United Kingdom (Ofgem) and Australia (AER).

<sup>83</sup> As discussed, in paragraphs 1.15-1.17.

## 4.6 Proposed templates

4.37 This section discusses the proposed templates in greater detail. Issues of general application are covered first, and then we discuss each of the individual template areas (network, expenditure, drivers, and network performance) in more detail.

### *General considerations*

- 4.38 The templates require prospective (forecast) and historic (actual) information on network data, expenditure, drivers, and network performance.<sup>84</sup> The prospective information will be required before the start of each disclosure year (at the same time as the AMP is due), while the historic information is due five months after the end of each disclosure year (when other historic information including historic financial performance is due).
- 4.39 The templates mainly require quantitative data. The AMP is likely to include more of the qualitative narrative adding the explanation and commentary to the raw numbers disclosed in the templates. This is important as the templates cannot, by themselves, attempt to capture adequately all considerations relevant to managing assets, some of which will be specific to each supplier. Suppliers may wish to include the templates in their AMP, but this is not a formal proposed requirement.
- 4.40 We expect that the templates will be easier for suppliers to update for annual reporting purposes, than the commentary-laden AMP. With the proposed change in disclosure frequency for the AMP (see paragraphs 4.68-4.72), regulated businesses will only need to update the templates for the purpose of annual disclosure.
- 4.41 The final templates will allow commentary to be included which set out the assumptions that the supplier has used in populating the template.
- 4.42 While the templates provide a snapshot view at one point in time, their greater benefit will come from providing a better view of asset management over time. Care needs to be taken in looking only at one year's data as this can be affected by one-off non-recurring events, and may imply network performance levels which are unrepresentative of underlying performance.
- 4.43 The templates cover four key areas: network data, expenditure, drivers and network performance for each regulated service. The templates require disaggregation of data in a number of areas, for example by breaking down asset information to show asset information by asset category or asset class. This level of detail is essential to compare performance information with asset condition and expenditure information.
- 4.44 We now discuss the four types of data templates and the information they require.

### *Network data*

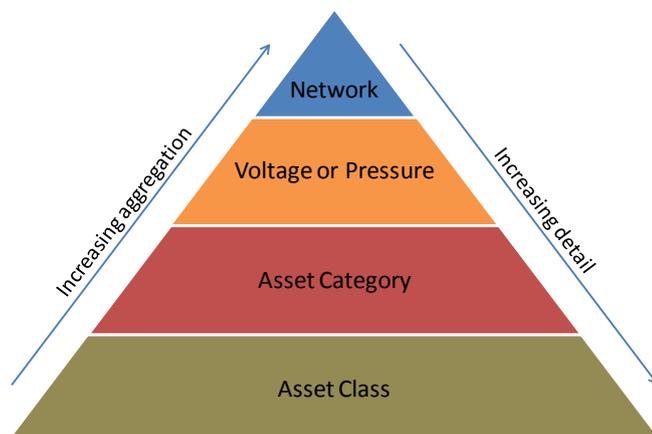
4.45 The Draft ID Determination seeks to standardise asset register information. The templates cover the asset register, asset additions, and asset disposals.

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<sup>84</sup> The templates are set out in Schedules 6-7, 14-16, 18-19 of the draft ID Determinations for all services.

- 4.46 Figure 4.4 shows the structure of the proposed asset register information. Disaggregation of network data into voltage or pressure categories and then asset categories and asset classes, assists analysis including analysing links between asset register information and asset expenditure information. This forms the backbone of all AMP templates.

**Figure 4.4: Standardised asset register information**



- 4.47 For EDBs, the operating 'voltage' classifications are:
- 4.47.1 Low voltage: below 1 kV
  - 4.47.2 High voltage: above 1 kV.
- 4.48 Assets that can be used for a range of voltages are associated with the highest voltage involved. Poles are not grouped by voltage; asset categories for poles are 'concrete', 'wood' and 'other'.<sup>85</sup>
- 4.49 For GDBs and GTBs, the operating pressure classification are:<sup>86</sup>
- 4.49.1 transmission/high pressure pipelines: operating pressures greater than 2,000 kPa
  - 4.49.2 intermediate pressure: operating pressures greater than 700 kPa and less than 2,000 kPa
  - 4.49.3 medium pressure: operating pressures up to 700 kPa.

#### *Expenditure data*

- 4.50 Table 4.5 shows the EDB opex categories from the current EDB ID requirements<sup>87</sup> and the proposed opex expenditure categories in the draft ID Determinations for EDBs, GPBs and GTBs. These expenditure categories have been identified following

<sup>85</sup> Asset register information is specified in Schedule 16 (Network Asset AMP Report) of each of the draft ID Determinations. Other general items are variously classified as 'Secondary assets' or 'Other assets'.

<sup>86</sup> The gas operating pressure classifications are consistent with NZS 558:1995. 'Medium pressure' incorporates the low pressure category from the New Zealand standard.

<sup>87</sup> The GIDRs do not prescribe opex categories.

discussion with the technical reference group and are intended to better capture the key activities undertaken by suppliers to provide the regulated service.

**Table 4.5: Current and proposed opex categories in ID requirements**

Current EDB ID opex categories	Proposed opex categories		
	EDB	GDB	GTB
Routine and preventative maintenance	Routine and preventative maintenance	Routine and preventative maintenance	Routine and corrective maintenance and inspection
Refurbishment and renewal maintenance	Vegetation management	Service interruptions and emergencies	Easement activity
Fault and emergency maintenance	Service interruptions and emergencies	System operations	Service interruptions, incidents and emergencies
System management and overheads	System operations	Network support	System management and operations
General management, administration and overheads	Network support	Business support	Business support
	Business support	Direct billing	Direct billing
	Direct billing		Compressor fuel
Other			

4.51 Key points to note in Table 4.5 are that:

- 4.51.1 'refurbishment and renewal maintenance' is classified as capex under GAAP and has been removed as an opex cost category
- 4.51.2 vegetation management has been split out from 'routine and preventative maintenance' for EDBs
- 4.51.3 opex not associated with particular assets (ie, opex previously categorised as 'general management, administration and overheads' and 'system management and operations') has been categorised as:
  - (a) 'system operations' and 'network support' (EDBs and GTBs only);
  - (b) 'system management and operations' (GTBs only)
  - (c) 'business support' (all regulated suppliers).

- 4.52 Table 4.6 shows the EDB capex categories from the current EDB ID requirements<sup>88</sup> and the proposed capex categories for EDBs, GPBs and GTBs.

**Table 4.6: Current and Proposed Capex categories in ID requirements**

<b>Current ID capex categories</b>	<b>Proposed capex categories for EDBs, GDBs and GTBs</b>
Customer connection	Customer connection
System growth	System growth
Asset replacement and renewal	Asset replacement and renewal
Reliability, safety and environment	Quality of supply
Asset relocations	Asset relocations
Non-system fixed assets	Legislative and regulatory
	Non-system fixed assets
	Capital contributions (income)

- 4.53 The 'Reliability, safety and environment' category in the current EDB ID requirements has been split into separate 'Quality of supply' and 'Legislative and regulatory' categories. We also propose a separate category for capital contributions, and splitting non-system fixed assets into atypical and routine expenditure categories. To help ensure this data is informative, we propose that much of the capex data is disclosed by asset class or category.
- 4.54 Revised cost definitions have been developed for those cost categories which remain unchanged, with new definitions for the new categories. This is intended to reduce the ambiguity in the current definitions and help ensure expenditure is categorised consistently to aid comparisons over time and across suppliers.
- 4.55 To compare planned expenditure with actual expenditure, interested persons require nominal expenditure forecasts (ie, forecast expenditure adjusted for inflationary effects such as CPI and changes in the cost of inputs). On the other hand, to understand whether the forecast expenditure of a particular operator is likely to be efficient or effective, interested persons require real expenditure forecasts. We are interested in receiving submissions as to whether suppliers should disclose separate real and nominal expenditure forecasts, or a nominal expenditure forecast combined with sufficient information on the inflationary assumptions used to enable interested persons to back out the real forecast. The draft ID Determinations require the disclosure of the nominal expenditure forecast and price inflator assumptions.

<sup>88</sup> The GIDRs do not prescribe capex categories.

### *Expenditure drivers (and effectiveness) data*

- 4.56 We have developed templates to capture standardised information on the key drivers of expenditure and on the measures of effectiveness of expenditure and the associated activity. By using this data in conjunction with the other data components of the AMP, interested persons will be able to assess whether suppliers are managing their assets for the long term and whether the level and timing of expenditure is efficient, such that it benefits consumers in the long term.
- 4.57 The drivers and measures in the templates were informed by the technical reference group and by submissions received on the cost efficiency consultation paper.<sup>89</sup> The drivers help to capture the key factors causing expenditure on each network, and to explain differences in expenditure over time and across networks. Identified cost drivers include the scale of the network, whether the network is in an urban or rural location, capacity and connection growth, and the age and condition of the network. Some of these drivers were provided in existing disclosures, including the AMP. However, they were not provided in a standardised format and are therefore of limited value in assessing whether the purpose of Part 4 is being met.
- 4.58 There are a large number of potential expenditure drivers, and the templates do not seek to require information on all such drivers. We expect suppliers will use their AMP and the commentary boxes within the templates to provide additional information on their asset management activities, the expenditure drivers, and the specific factors (which may be unique to them) which materially affect their asset management activities and expenditure.

### *Performance information*

- 4.59 The network performance templates capture EDB and GPB information on the number and cause of faults and metrics that relate to interruptions to consumer supply. This information is disaggregated according to asset category and asset class.
- 4.60 In the case of GPBs, interruptions to supply are infrequent. This makes interruption metrics a less effective indicator of network performance than for EDBs. As a result, the network performance templates for GPBs take a broader approach to measuring network performance. The GDB performance templates are largely based on the quality performance compliance requirements that applied to Powerco and Vector in the 2008 Commerce Commission Authorisations.<sup>90</sup>

### *Application to other instruments and sectors*

- 4.61 The proposed information templates are intended to provide sufficient information to interested persons to enable them to assess whether the purpose of Part 4 is being met. We expect the information templates and the AMPs will provide sufficient information on the management of assets to undertake our summary and

<sup>89</sup> Commerce Commission, *Information Disclosure: Approaches for Understanding EDB and GPB Cost Efficiency - Technical Paper for Consultation*, 7 October 2011. Submissions on this paper are on the Commission's website at [www.comcom.govt.nz/part-4-review-of-electricity-information-disclosure-requirements/](http://www.comcom.govt.nz/part-4-review-of-electricity-information-disclosure-requirements/), under the heading 'Submissions on Approach to Assessing EDB and GPB Cost Efficiency'.

<sup>90</sup> Re Vector Limited [2008] NZCC 656; Re Powerco Limited [2008] NZCC 656.

analysis. We are continuing to develop and refine our proposals to summary and analysis and will seek submissions on these proposals.

- 4.62 In our Airports ID Determination<sup>91</sup> we did not require the disclosure of templates analogous to those proposed for EDBs and GPBs. This reflects a number of factors, including:
- 4.62.1 the different regulatory regime airports operate under, including the consultation processes and pricing periods already established under that regime
  - 4.62.2 the nature, number, complexity and interdependency of the assets for energy have different implications for performance compared to an airport
  - 4.62.3 that our approach to asset management information disclosures has developed over time.
- 4.63 Further consideration may be given to whether asset related disclosures in the airports context should be amended at some future point in time (ie, whether the requirements for airports should more closely reflect the approach now proposed in the draft ID Determinations for EDBs and GPBs).

#### **4.7 Generic issues regarding the disclosure of AMPs**

- 4.64 This section discusses:
- 4.64.1 why we still require an AMP to be disclosed
  - 4.64.2 why we propose that AMPs should be disclosed biennially, and what information should be disclosed between those biennial AMP disclosures
  - 4.64.3 our proposed approach to future reviews of disclosed AMPs.

##### *Why AMPs should still be disclosed*

- 4.65 Notwithstanding the quantitative information that will be required through the information templates, we consider disclosure of an AMP is also necessary.
- 4.66 An AMP is necessary as the information templates do not cover all topics and issues covered in the AMP (for example, the criteria for network planning, consumer engagement, the supplier's asset management policies are not included). Also, the AMP provides a more flexible disclosure for suppliers to tailor the disclosures to their needs, strategies and to include commentary on aspects of asset management that are specific to them.
- 4.67 Further, in our IM Reasons paper, we decided not to do ex post reviews of capex under CPPs that might involve a writedown of the RAB as we thought the

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<sup>91</sup> *Commerce Act (Specified Airports Services Information Disclosure) Determination 2010* [2010] NZCC 715.

requirement to disclose AMPs provides a discipline on the prudence of capex.<sup>92</sup> Retaining AMPs is consistent with this decision.

*Why we propose AMPs should be disclosed biennially*

- 4.68 EDBs are currently required to disclose an AMP annually prior to the start of each year. A number of suppliers raised concern about the cost of annually disclosing their AMPs. They proposed that we should require AMPs to be disclosed less frequently, for example, every two or three years.
- 4.69 In 2011 the ENA collated its members' views on improvements to the asset management plan requirements. When viewed over a ten year planning period, the annual variances that affect investment plans were considered to not significantly influence the essence of the AMP. Respondents noted the significant amount of time taken to update their AMPs, including the processes required to obtain Board approval. A requirement to only publish AMPs once every two years would, they proposed, deliver significant time-savings to EDBs, and ultimately benefit consumers. The savings would result from the fact that a formal disclosure document would not have to be prepared, with the concordant internal and external quality reviews.<sup>93</sup> Powerco made a similar proposal to the Commission at the 20 May 2011 workshop on GPB AMP requirements.<sup>94</sup>
- 4.70 In informal discussions with a range of interested persons, representing consumer and other stakeholders,<sup>95</sup> we discussed the proposal to require AMPs to be disclosed biennially. Most generally supported this approach, noting that AMPs typically did not change significantly from year-to-year. A number of stakeholders that we spoke to were, however, concerned that some form of update to the AMP should be required in the intervening year, to ensure information on any material changes was available.
- 4.71 The Commission agrees with these points, and proposes that AMPs should be disclosed at least biennially, with a limited AMP Update disclosed in the intervening year, which informs interested persons on material changes to the most recently disclosed AMP.
- 4.72 Any supplier that wishes to continue to disclose an AMP annually can do so. The draft ID Determinations do not require a supplier to disclose an AMP Update if that supplier continues to disclose an AMP in each year.<sup>96</sup>

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<sup>92</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraph E4.6–E4.7.

<sup>93</sup> Letter from Nathan Strong (Chair, ENA Regulatory Working Group) to Karen Murray (Acting Manager, Regulation Branch, Commerce Commission) responding to a request to collate views on improvements that could be made to the current Asset Management Plan requirements, 3 August 2011.

<sup>94</sup> Commerce Commission, *Gas Pipeline Services Asset Management Plan Requirements Workshop Minutes*, 20 May 2011, p.3.

<sup>95</sup> As discussed in paragraph 2.36.3.

<sup>96</sup> Clause 2.3, section 2.5 of each of the draft ID Determinations.

### *What information is required in the AMP Update*

4.73 AMP Updates are intended as a short update to the previously disclosed AMP. They should outline material changes to the AMP. AMP Updates cannot replace an AMP for two years in a row. The AMP Update is expected to cover the following points, where applicable:

- 4.73.1 any major changes to the network development plans disclosed in the last AMP
- 4.73.2 any major changes to lifecycle (maintenance and renewal) plans disclosed in the last AMP
- 4.73.3 the reasons for any material changes made since the previous disclosure year to the Network Expenditure AMP Report.<sup>97</sup>

### *Future compliance reviews of disclosed AMPs*

4.74 For a number of years, the Commission has undertaken reviews of EDB AMPs. These reviews have taken what, in essence, is a compliance approach whereby an external consultancy has been asked by us to review each EDB's AMP for compliance with the AMP requirements.

4.75 The most recent review, of the EDB AMPs covering the planning period 1 April 2011 to 30 March 2021, was prepared by Parsons Brinckerhoff NZ (Parsons Brinckerhoff Review).<sup>98</sup> The Parsons Brinckerhoff Review focused on compliance with three specific aspects of the requirements, namely service levels; network development planning; and expenditure forecasts, reconciliations and assumptions.

4.76 The Parsons Brinckerhoff Review identified that compliance levels continue to improve, and that most AMPs were now fully compliant with the criteria in those areas. Parsons Brinckerhoff did not propose changes to the AMP requirements in response to its review of compliance in the three areas under assessment.

4.77 We may continue similar compliance reviews in future but, for EDBs in particular, these may be less frequent and targeted on limited areas where specific compliance issues have been identified. They could also include greater use of site visits which we used for the 2011 AMP reviews.

## **4.8 The AMP requirements for GPBs**

4.78 As noted above, we consider that GPBs should disclose an AMP.<sup>99</sup> This section discusses how we developed the proposed AMP requirements for GPBs.

4.79 In the GPB AMP workshop on 20 May 2011 we proposed using the EDB AMP requirements as a starting point from which to develop GPB specific AMP

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<sup>97</sup> Clause 2.4, section 2.5 of each of the draft ID Determinations.

<sup>98</sup> See Parsons Brinckerhoff New Zealand, *2011 Asset Management Plan Reviews*, 26 August 2011; and is on the Commission's website at [www.comcom.govt.nz/review-of-asset-management-plans/](http://www.comcom.govt.nz/review-of-asset-management-plans/).

<sup>99</sup> At paragraphs 4.16-4.17, and 4.26.

requirements. Workshop attendees accepted this approach but were concerned that the scope of the regulatory AMP should be constrained to limit the cost of preparation.<sup>100</sup>

- 4.80 Workshop attendees identified a number of differences between EDBs and GPBs which they considered should be reflected in AMP requirements for GPBs. Relevant differences included:
- 4.80.1 that GPBs are generally smaller businesses with fewer staff than EDBs
  - 4.80.2 the lumpy and uncertain nature of capital investment on gas pipelines, and whether it is therefore appropriate for forecast horizons to be more than a year or as long as 10 years, and whether scenarios should be used
  - 4.80.3 the potential for confidential information to be specified as a disclosure requirement
  - 4.80.4 whether SAIDI and SAIFI measures are appropriate for GPBs, particularly GTBs
  - 4.80.5 the paramount importance of safety in the operation of a GPB
  - 4.80.6 that the definition of geographically non-contiguous networks used for EDBs is not appropriate for GDBs (could potentially result in a large number of such regions).<sup>101</sup>
- 4.81 Other GPB-specific issues raised at the workshop included whether disclosing pressure, flows and throughput at numerous points on their network would be a more realistic and useful measure of capacity than the current capacity measure.<sup>102</sup>
- 4.82 We have endeavoured to address the points raised at the May 2011 workshop in the draft GPB AMP requirements. In particular:
- 4.82.1 the AMP requirements provide for a probabilistic approach to network development planning and specifically allow for discussion of a range of future demand scenarios for suppliers to reflect any lumpiness and uncertainty of future gas pipeline investments
  - 4.82.2 SAIDI and SAIFI measures are retained for GDBs, but we have broadened the range of asset management information, including performance information, to be disclosed

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<sup>100</sup> Commerce Commission, *Gas Pipeline Services Asset Management Plan Requirements Workshop Minutes*, 20 May 2011, p.3.

<sup>101</sup> Commerce Commission, *Gas Pipeline Services Asset Management Plan Requirements Workshop Minutes*, 20 May 2011, p.3-5.

<sup>102</sup> Commerce Commission, *Gas Pipeline Services Asset Management Plan Requirements Workshop Minutes*, 20 May 2011, p.3-5. The current capacity measure is included in the Gas (Information Disclosure) Regulations 1997, Schedule 1, Part 5.

- 4.82.3 the templates require additional information on asset condition, age and risk of failure
- 4.82.4 the definition of sub-networks has been defined for GPBs such that MDL, Vector transmission and GasNet are required to disclose information only in respect of a single network, and Vector distribution and Powerco are each required to disclose information only in respect of two sub-networks<sup>103, 104</sup>
- 4.82.5 for GDBs, the disclosure requirements propose that capacity planning and availability disclosures be based on gas pressure, in line with the suggestions put forward at the GPBs AMP workshop.<sup>105</sup>
- 4.83 While the draft AMP requirements for GPBs are similar in length and content to those for EDBs, to the extent that GPBs are simpler businesses we would expect this to be reflected in shorter and simpler AMPs for GPBs than for EDBs.

#### **4.9 The AMMAT—assessing asset management maturity**

- 4.84 This section discusses the proposed requirement for regulated suppliers to undertake and disclose a self-assessment of the maturity of its practices in relation to asset management.
- 4.85 In response to concerns around the management of infrastructural assets internationally, asset managers and their advisers have undertaken a number of initiatives to improve the management of assets, including infrastructural asset management. One such measure has been the development of more rigorous standards of what constitutes good asset management (such as PAS 55).
- 4.86 We do not consider that it is appropriate or necessary for us to specify comprehensive standards on asset management as each supplier should adopt whatever standard or approach it considers is most appropriate for it. However, given the importance of asset management to the quality and the cost of services that consumers receive over time, interested persons should understand whether suppliers are reviewing their asset management practices in an on-going manner, and whether this has identified areas where improvements in the management of assets are possible.
- 4.87 One such approach is to review the asset management practices against international standards of good asset management such as PAS 55.<sup>106</sup> This may

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<sup>103</sup> The proposed geographic coverage of each Powerco GDB sub-network is that suggested by Powerco following the 2 May 2011 GPB AMP workshop. Under the gas authorisation, Powerco disclosed quality information for 5 separate regions: Hawkes Bay, Manawatu/Horowhenua, Wellington, Hutt Valley/Porirua and Taranaki.

<sup>104</sup> The proposed geographic coverage of each Vector GDB sub-network is as proposed by Vector in: Vector Ltd, *Cross-submission on Gas DPP discussion paper*, 18 June 2011, pp1–2. The gas authorisation required that Vector disclose quality information for the Auckland region.

<sup>105</sup> Commerce Commission, *Gas Pipeline Services Asset Management Plan Requirements Workshop Minutes*, 20 May 2011, p.3-5. The current capacity measure is included in the Gas (Information Disclosure) Regulations 1997, Schedule 1, Part 5.

identify areas where the supplier's performance is below, or above, that of other suppliers, and may identify problem areas and opportunities for improvement. Any such improvements may produce enduring improvements in asset management, to the long term benefit of suppliers and consumers.

- 4.88 We asked Parsons Brinckerhoff NZ to consider and recommend an approach to assess the maturity of the asset management capability and practices within EDBs. The AMMAT developed by Parsons Brinckerhoff NZ is based on the PAS 55 Assessment Methodology. It does not, however, require firms to seek certification with PAS 55 or to adopt formally this standard.
- 4.89 We propose suppliers should complete and disclose the results of the AMMAT. This tool is set out in Schedule 17 of the each draft ID Determinations. The AMMAT seeks to identify the gaps between the current asset management practices suppliers use and best practice asset management as determined under PAS 55.
- 4.90 Disclosure of the AMMAT will enable more transparent disclosure of how well assets are being managed against an objective standard. Disclosure of the AMMAT results does not require a regulated supplier to lift its asset management capabilities to a higher level of maturity, but it makes the decision to settle for a lower standard a more conscious and transparent one.
- 4.91 A draft version of the AMMAT was discussed by a number of parties at our workshop on June 27, 2011.<sup>107</sup> A number of comments on the draft AMMAT were made at the workshop,<sup>108</sup> and Parsons Brinckerhoff NZ has made a number of changes in response. The final report from Parsons Brinckerhoff NZ is available on our website.<sup>109</sup>
- 4.92 Completing the AMMAT requires the supplier to identify references to its own documents that support its assessment of its maturity rating. This allows the possibility that we could commission an audit by a qualified independent person of the responses in the AMMAT disclosures. This could be separate to, or form part of, a review of the AMP disclosures as discussed above in paragraphs 4.74 – 4.77.

#### **4.10 Other changes to the AMP requirements applying to EDBs and GPBs**

- 4.93 The draft EDB ID Determination proposes that a number of other changes should be made to certain aspects of the existing EDB AMP requirements. Except where stated, these changes would apply to both EDBs and GPBs. These changes are briefly discussed below.

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<sup>106</sup> PAS 55 was developed by the Institute of Asset Management (UK), and can be purchased from its website at [www.theiam.org/](http://www.theiam.org/)

<sup>107</sup> Commerce Commission, *Electricity Distribution Services Asset Management Tool Workshop Details*, 27 June 2011.

<sup>108</sup> Commerce Commission, *Electricity Distribution Services Asset Management Tool Workshop Minutes*, 27 June 2011.

<sup>109</sup> Parsons Brinckerhoff NZ, *Asset Management Maturity Assessment Tool Final Report*, 27 September 2011. <http://www.comcom.govt.nz/part-4-review-of-electricity-information-disclosure-requirements/> under the heading 'Asset Management Maturity Assessment Tool (AMMAT) study'.

- 4.94 The AMP should include improved disclosure in the following areas:
- 4.94.1 Network resilience to high impact, low probability events: asset failures in electricity distribution and/or gas pipelines can have a significant impact on consumers. Such failures may be due to events which are foreseeable, but have low probability. The AMP requirements have been revised to encourage greater disclosure of scenario testing, and contingency planning, for such events<sup>110</sup>
  - 4.94.2 Company policies on investments in load loss management, for EDBs: EDBs investment choices can involve trade-offs between higher and lower levels of expected load losses (for example, whether to invest in low loss transformers, or lower cost, less efficient alternatives). The draft ID Determination promotes greater transparency on the investment decisions that EDBs make in this regard, including disclosure of asset purchasing strategies that promote the energy efficient operation of the network<sup>111</sup>
  - 4.94.3 Consumer engagement processes and outcomes: effective consumer engagement is essential to suppliers' understanding of consumer expectations and consumers' willingness to pay for service upgrades. The Draft ID Determination does not prescribe how such engagement should be done, but it does require each supplier to outline how they engage with consumers and how consumers' views are incorporated into the supplier's asset management strategy and AMP<sup>112</sup>
  - 4.94.4 Sub-networks (previously non-contiguous networks): These are discussed separately below in paragraphs 4.95–4.99
  - 4.94.5 Embedded distribution networks: EDBs must disclose, in their Network Driver AMP Report, the location and number of ICPs served, and total revenue of each distribution network embedded within other EDB networks.<sup>113</sup>
  - 4.94.6 Distributed Generation: to assess EDB expenditure in connecting distributed generation, actual and forecast information on the number of connections and expenditure on connections is disclosed.<sup>114</sup>
  - 4.94.7 Innovative practices, processes, or programmes: the AMP requirements include disclosure of planned innovations that improve efficiencies within the network and strategies or processes that promote efficient operation of

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<sup>110</sup> Clauses 16-17 of Appendix A of the draft EDB ID Determinations; Clause 18.2-18.4 of Appendix A of the draft GDB ID Determinations, Clause 17-18 of Appendix A of the draft GTB ID Determinations.

<sup>111</sup> Clause 11.5 of Appendix A of the draft EDB ID Determinations.

<sup>112</sup> Clauses 3.6 and 8 of Appendix A of the draft EDB ID Determinations; Clauses 3.6 and 12 of Appendix A of the draft GDB ID Determinations, Clauses 3.6 and 12 of Appendix A of the draft GTB ID Determinations.

<sup>113</sup> See schedule 15 of the draft EDB ID Determination. Clause 13 of Appendix A of that draft determination also requires the disclosure of policies on distributed generation.

<sup>114</sup> We have not defined the term distributed generation in the draft ID Determinations. We invite submissions as to whether this is desirable.

the network, for example, though network design or demand side management<sup>115</sup>

- 4.94.8 The AMP requirements contain a disclosure requirement concerning the approaches and practices of the supplier concerning insurance, and details concerning self-insurance<sup>116</sup>
- 4.94.9 Network maps: many EDB AMPs have in the past contained maps and diagrams. The requirements suggest that the Assets Covered section of each AMP include network maps and a single line diagram of the sub transmission network to help clarify the network descriptions.<sup>117</sup>

#### 4.11 Sub-networks

- 4.95 Under the current EDB ID requirements there are four instances where EDBs disclose information by sub-network. The four instances are:
  - 4.95.1 MP1 Network Information
  - 4.95.2 MP3 Price and Quality Measures
  - 4.95.3 AMP (peak demand and total electricity delivered in the previous year)
  - 4.95.4 AMP (description of the network configuration).
- 4.96 In practice, five EDBs disclose this information by sub-network. Three (Eastland, Unison and Vector) do so because their businesses are consumer-controlled and the number of controlling consumers is less than 90% of the total number of consumers. Two (Aurora and Powerco) do so because they have 'non-contiguous' networks as defined in the disclosure requirements.<sup>118</sup>
- 4.97 The other situation under the current EDB disclosure regulations in which an EDB is required to disclose information by non-contiguous network follows a merger or asset transfer between EDBs.<sup>119</sup> We propose to retain these requirements in respect of sub-networks.
- 4.98 We consider that a controlling ownership of a company by fewer than 90% of its consumers justifies a need for interested persons to be able to separately assess a supplier's network, price and performance information by sub-network. The same is true where distinctions between the serviced regions may result in substantial

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<sup>115</sup> Clause 11.9.3 of the draft EDB ID Determinations; clause 15.9.3 of the draft GDB ID Determinations; and clause 15.10.3 of the draft GTB ID Determinations.

<sup>116</sup> Clauses 18 of Appendix A of the draft EDB ID Determinations; clause 18.5 of Appendix A of the draft GDB ID Determinations; and clause 19 of Appendix A of the draft GTB ID Determinations.

<sup>117</sup> Commentary to subclause 4.2.6 of Appendix A of the draft EDB ID Determinations; commentary to clause 6.2 of Appendix A of the draft GDB ID Determinations

<sup>118</sup> Commerce Commission, *Electricity Distribution (Information Disclosure) Requirements 2008*, 31 October 2008, clause 2(1).

<sup>119</sup> Commerce Commission, *Electricity Distribution (Information Disclosure) Requirements 2008*, 31 October 2008, clause 6(4).

differences in performance, expenditure or expenditure drivers between the regions, particularly if the incremental cost of disclosing by sub-networks is low. We propose that these two companies continue to disclose network, price and performance information by these specified sub-networks. The Commission expects in future to consider the location of specified sub-networks based on distinctions between serviced regions.

- 4.99 GDBs have a number of geographically distinct sub-networks. Application of the existing EDB definition of non-contiguous networks to GDBs, could potentially capture a large number of sub-networks (which would potentially multiply disclosure obligations).<sup>120</sup> We propose that Vector discloses network, price and performance information for two gas distribution regions: Auckland; and other North Island. We understand these regions correspond to Vector's internal reporting structure. We propose that Powerco also discloses network, price and performance information for two gas distribution regions: Wellington and the Hutt Valley / Porirua; and Hawkes Bay, Manawatu/Horowhenua, and Taranaki.
- 4.100 The draft ID Determinations do not include disclosure of expenditure and asset and network driver data by sub-network. We invite submissions on whether expenditure, and asset and network driver data, should be disclosed by sub-network. This additional information would assist interested persons to understand any differences in performance and investment across the sub-networks. It would also help interested persons to assess whether suppliers are investing appropriately in each of their sub-networks given any materially different characteristics or performance in the sub-networks, or where suppliers may have an incentive to under- or over-invest in a sub-network. We are particularly interested in feedback on whether the separate disclosure of this information would be relevant to the 'non-contiguous' EDB networks owned by Powerco and Aurora and the geographically distinct GDB networks, as well as those sub-network EDB businesses that are consumer-controlled and where the number of controlling consumers is less than 90% of the total number of consumers (ie, Vector, Unison and Eastland).

#### **4.12 Disclosure of gas transmission capacity information**

- 4.101 There is concern from a number of interested persons around the capacity of gas transmission pipelines. We have identified four areas where we consider there is currently insufficient information about the capacity of gas transmission capacity, for interested persons to assess whether the Part 4 Purpose is being met. These are:
- 4.101.1 whether current physical capacity is adequate to address the current and future needs of consumers
- 4.101.2 whether current capacity allocation methodologies result in efficient outcomes

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<sup>120</sup> For example, Powerco estimates that under the non-contiguous definition previously applying to EDBs, its GDB would need to disclose separate data for 35 sub-networks. See Commerce Commission, *Gas Pipeline Services Asset Management Plan Requirements—Workshop Minutes*, pp5–6.

- 4.101.3 whether the planned investment is adequate to meet consumer needs (given any physical capacity constraints)
- 4.101.4 whether, and if so, how any of the above factors is impacting upon the quality of service provided to existing contracted customers.
- 4.102 Interested persons wishing to form a judgement on whether physical pipeline capacity is adequate to address current and future needs require information on peak demand and available capacity.
- 4.103 Under Part 5 of the GIDRs, GPBs are currently required to make a pipeline capacity disclosure within two months after the end of each financial year. Disclosure of these reports is continued under the draft ID Determinations.
- 4.104 GPBs have expressed to the Commission their doubt about the usefulness of the ‘numerical factor’ component of this report.<sup>121</sup> The numerical factors, derived using computer models, indicate the headroom available at each major gas offtake point if the constraints at one intake point are relaxed and the conditions at all other intake and offtake points are held identical to those that applied during the period of system peak flow in the last year.
- 4.105 GDBs have advised us that the major indicators that they use for capacity planning involve observations and rules concerning the rate of change of pressure drop with increasing load. We consider it preferable for the capacity disclosure requirements to relate to the capacity planning methods implemented by suppliers unless there is evidence that they do not reflect best asset management practice or that the disclosures would not meet the assessment needs of interested persons. Under the proposed requirements, GDBs are not required to disclose numerical factors, but instead are required to provide in their AMP template disclosures the actual pressures and operating ranges for pressure systems operating in the lower end of the operating range. We also propose that GDBs continue to disclose the peak flow information that is currently required under Part 5 of the GIDRs.
- 4.106 The computer models and assumptions used by GTBs to determine capacity availability are similar to those that are used to derive numerical factors. However, as observed by Vector, there are two important differences between the modelling approaches in the GIDRs and in the company’s capacity planning.<sup>122</sup> The GIDRs are based on:
- 4.106.1 the peak offtakes that occurred during the previous year. These peak loads are less than the firm transmission capacity requirements that Vector derives in its capacity modelling; and

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<sup>121</sup> For example, Vector considers that the numerical factor presents “a very subjective number of little value to pipeline users”. See Commerce Commission, *Gas Pipeline Services Asset Management Plan Requirements—Workshop Minutes*, Appendix 2.

<sup>122</sup> Vector Limited, *Gas Transmission System: Physical Model Inputs Discussion Paper*, 7 November 2011, p20 paragraph 5.5.5, ‘Peak Week for Information Disclosure Modelling’. From <http://www.vector.co.nz/gas/pipeline-capacity-consultation/documents>.

- 4.106.2 the peak 7-day week flow profiles from the previous year. Vector uses a 5-day week for its capacity modelling, reflecting its experience that the aggregate load on the system occurs as a result of weekday demand and that taking the weekends into account can mask periods of high load.
- 4.107 We propose that GTBs continue to disclose pipeline capacity information including numerical factors.<sup>123</sup> Under the GIDRs these disclosures were made 2 months after the end of each financial year. Under the draft GTB ID Determination, these disclosures are due 5 months after the end of the financial year and, with the other disclosures due at that time, will require director certification. The disclosures for GTBs would include numerical factors using 5 day week peak load profiles from the previous year. We propose that GTBs also disclose numerical factors that are based on the theoretical peak offtakes that would have occurred during the previous year if, during the identified period of peak usage, consumption had been at a (probabilistic) high. We note that Vector is considering how to implement such an analysis, to better align it with international best practice such as the use of a 1 in 20 approach to capacity planning.<sup>124</sup>
- 4.108 Information is also required to assist interested persons to assess whether the approaches used by GPBs to allocate capacity result in an efficient allocation of that capacity. To aid this assessment we propose that GTBs describe in the pipeline capacity disclosures:
- 4.108.1 the total number of requests received by the GTB for the reservation of capacity on the transmission network, specifying the number of requests and associated capacity:
- (a) received
  - (b) fulfilled in full
  - (c) fulfilled in part
  - (d) not fulfilled.
- 4.108.2 the methodologies used to determine which requests were fulfilled and the reasons for the requests not being fulfilled; and
- 4.108.3 any measures intended to enable similar requests for reserved capacity to be fulfilled in the future.
- 4.109 We anticipate that interested persons seeking to assess the efficiency of planned investment would turn to the information in the AMP. Because GTB services are provided to a small number of large individual customers, demand/supply forecasts are critical and an interested person needs to be able to understand how the

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<sup>123</sup> See: Draft GTB ID Determination, clause 6 of section 2.5 and Appendix B.

<sup>124</sup> Vector Limited, *Gas Transmission System: Physical Model Inputs Discussion Paper*, 7 November 2011, p19 paragraph 5.5.2, 'Variation in Peak Demand Over Time'.

planned investments relate to expectation concerning future transmission opportunities. This is not straightforward since, as noted by the Gas Industry Company (GIC), the fragmented nature of the New Zealand gas market supply chain and the diversity in size and type of natural gas consumers mean that no single entity has an overview of the supply/demand outlook for the industry as a whole.<sup>125</sup>

- 4.110 The GIC, in response to industry concerns about the possible need for new transmission pipeline investment in the Auckland region, has initiated a supply/demand outlook project that it considers might be transferred to a government department or agency to maintain and update. To help interested persons understand how each of the GTB's planned investments support any such forecasts, we propose to require that GTB AMPs describe the extent to which the disclosed network development plans meet the loads anticipated in demand forecasts prepared by bodies such as the Gas Industry Company or the Ministry of Economic Development.<sup>126</sup>
- 4.111 The fourth aspect of gas transmission capacity that we consider to be of particular relevance to interested persons concerns the disclosure of information that demonstrates whether or not purchasers of capacity get what they contract for. The draft determination does not include a requirement for this information and we invite suggestions on whether such information should be required to be disclosed, and how any such requirement should be worded.

#### **4.13 Transitional provisions**

- 4.112 We consider the asset management information prescribed in the draft ID Determinations to be comparable to information that suppliers could be expected to use in managing their own business.
- 4.113 Some asset management information proposed for disclosure in the asset management templates is new, that is, it is not currently disclosed under the EDB information disclosure requirements or the GIDRs. Although some of the GDB information is disclosed by Powerco's gas distribution business and Vector's Auckland gas distribution business under current Commerce Commission authorisation requirements, it is not disclosed by all GDBs. Some information is collected by some suppliers for their own use, but this is not universally the case.
- 4.114 Therefore, some suppliers will have good quality data available to complete the templates, for some the data is available now but it includes estimates or default dates, and for some the data is not yet available.
- 4.115 If the asset management template information is available, it should be disclosed. There are two methods for completing asset management template tables when the information is not available:

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<sup>125</sup> Gas Industry Company, *Request for Expressions of Interest: Gas supply and demand outlook*, November 2011, p1. From [www.gasindustry.co.nz/work-programme/gas-transmission-investment-programme?tab=2134](http://www.gasindustry.co.nz/work-programme/gas-transmission-investment-programme?tab=2134).

<sup>126</sup> Clause 15.12 of Appendix A of the draft GTB ID Determinations.

4.115.1 Some tables contain provision for 'N/A' (not available) to be entered as data

4.115.2 Some tables require that data be provided, but allow for estimated data to be used. These tables require that a self-assessed data accuracy rating be disclosed. The accuracy rating must be reduced to the top rating by a specified date.

4.115.3 Some data does not require disclosure during the 2012 disclosure year

4.116 The transition provisions for asset management data are shown in Table 4.7.

**Table 4.7: Transition provisions for asset management data**

<b>EDB Schedule</b>	<b>Table Name</b>	<b>N/A disclosure may be made until (and excluding) the disclosure year below</b>	<b>Top accuracy rating of disclosed data not required until the disclosure year below</b>	<b>No disclosure is required until the disclosure year below</b>
<b>14 Network Expenditure AMP Report</b>				
14A(i)	Customer Connection	2015		
14A(ii)	System Growth	2015		
14A(iii)	Asset Replacement & Renewal	2015		
14A(vi)	Non-system fixed assets	2013		
<b>15 Network Driver AMP Report</b>				
15A(i)	Subtransmission Circuits	2015		
15A(ii)	Distribution Circuits	2015		
<b>16 Network Asset AMP Report</b>				
16A	Asset Register, Changes and Health (Asset health component only)		2018	2013
16B	Asset Age	2015		

## Chapter 5: Disclosure of Pricing and Related Information

Description and link to part 4 purpose	<p>Pricing disclosures assist interested persons to understand how prices are set, whether the prices reflect the principles of efficient pricing, and to compare prices for different consumer groups.</p> <p>Pricing and related disclosures help interested persons assess whether suppliers are providing services at a quality that reflects consumer demands and whether suppliers are sharing with consumers the benefits of efficiency gains through lower prices.</p>
Main changes proposed to disclosure requirements for EDBs and GPBs	<p>The draft ID Determinations retain requirements for disclosure of a pricing methodology and prices, for both EDBs and GPBs.</p> <p>Key changes are that EDBs and GPBs will now be required to:</p> <ul style="list-style-type: none"> <li>• discuss the extent of consistency with pricing principles in their pricing methodology</li> <li>• explain changes in target revenue (where applicable) and prices over time</li> <li>• explain their medium-term pricing strategy (if any) and any implications for future line charges</li> <li>• disclose capital contribution policies, and to explain how the amount of a capital contribution is determined</li> <li>• disclose additional information on their approach to non-standard contracts, including when they are used, and the extent of their use.</li> </ul> <p>Most prescribed terms and conditions of non-standard contracts are now required only to be made available on request. Prescribed terms and conditions of contracts are extended to include provisions regarding rights and responsibilities following interruptions to supply.</p>
Changes specific to GPBs	GPBs will be required to disclose pricing statistics.
Reference in draft ID determination requirements	Section 2.4 – Pricing information, and Schedule 13.

## 5.1 Introduction

- 5.1 This chapter sets out our reasons for draft decisions on the disclosure of pricing-related information for EDBs and GPBs. This chapter discusses:
- 5.1.1 the purpose of pricing-related disclosures (Section 5.2)
  - 5.1.2 our general approach to the disclosure of pricing-related information (Section 5.3)
  - 5.1.3 disclosure of pricing methodologies for:
    - (a) prices, including the disclosure of approaches to non-standard contracts, distributed generation, engagement with consumers over prices, and director certification (Section 5.4)
    - (b) capital contributions (Section 5.5)
  - 5.1.4 disclosure of prices (Section 5.6)
  - 5.1.5 disclosure of prescribed terms and conditions of contracts (Section 5.7)
  - 5.1.6 disclosure of pricing statistics (Section 5.8)
  - 5.1.7 disclosure of pricing information by sub-network (Section 5.9)
  - 5.1.8 disclosure of the details of discretionary discounts and rebates (Section 5.10)
  - 5.1.9 whether to require disclosure of certain policies as proposed in the IM Discussion Paper (Section 5.11) and
  - 5.1.10 transitional provisions (Section 5.12)

## 5.2 Purpose of pricing disclosures

- 5.1 In workably competitive markets, prices signal the economic costs of service provision to consumers. The price mechanism balances supply and demand and provides incentives to suppliers to improve efficiency, and to invest and innovate where and when required. In such markets, there is significant information available to buyers and sellers, and consumers can compare the prices of various suppliers, choose between suppliers and goods or services, and make trade-offs between price and quality. Suppliers seek efficiencies or innovations to ensure the price and quality of their offer is competitive against that of other suppliers. In addition, in workably competitive markets risks will be managed efficiently, by allocating identified risks to the party considered best placed to manage them (eg, through the contractual terms and conditions).
- 5.2 In markets without workable competition, there is an asymmetric distribution of pricing and related information between buyers and sellers, and consumers' choices are fewer. Suppliers' incentives to provide services or a quality demanded by

consumers may be weak and a supplier may use its power to dictate terms and conditions, including the transfer of risk to consumers.

- 5.3 For services regulated under Part 4, information disclosure can improve the distribution of information between regulated suppliers and interested persons (including consumers). The Act provides for the disclosure of prices, terms and conditions relating to prices, pricing methodologies, and contracts.<sup>127</sup> Through the disclosure of such information, information disclosure regulation can promote outcomes consistent with those observed in workably competitive markets. That is, it can reduce the information asymmetry consumers face in markets for services without workable competition and enable consumers to engage in an informed way with their suppliers on the prices for regulated services.
- 5.4 The disclosure of pricing information helps interested persons to assess whether the purpose of Part 4 is being met. In particular, the disclosure of pricing and related information helps interested persons to:
- 5.4.1 know the prices for regulated services
  - 5.4.2 understand how these prices were set
  - 5.4.3 compare prices set for different consumer groups
  - 5.4.4 better understand the extent to which regulated suppliers are applying efficient pricing principles
  - 5.4.5 understand who bears what risks and help assess whether contracts are allocating risks to the party best placed to manage them
  - 5.4.6 assess whether suppliers are sharing with consumers the benefits of efficiency gains in the supply of the regulated goods or services through lower prices (s 52A(1)(c))
  - 5.4.7 assess whether prices reflect the service quality demanded by consumers (s 52A(1)(b)).

### **5.3 General approach to the disclosure of pricing information**

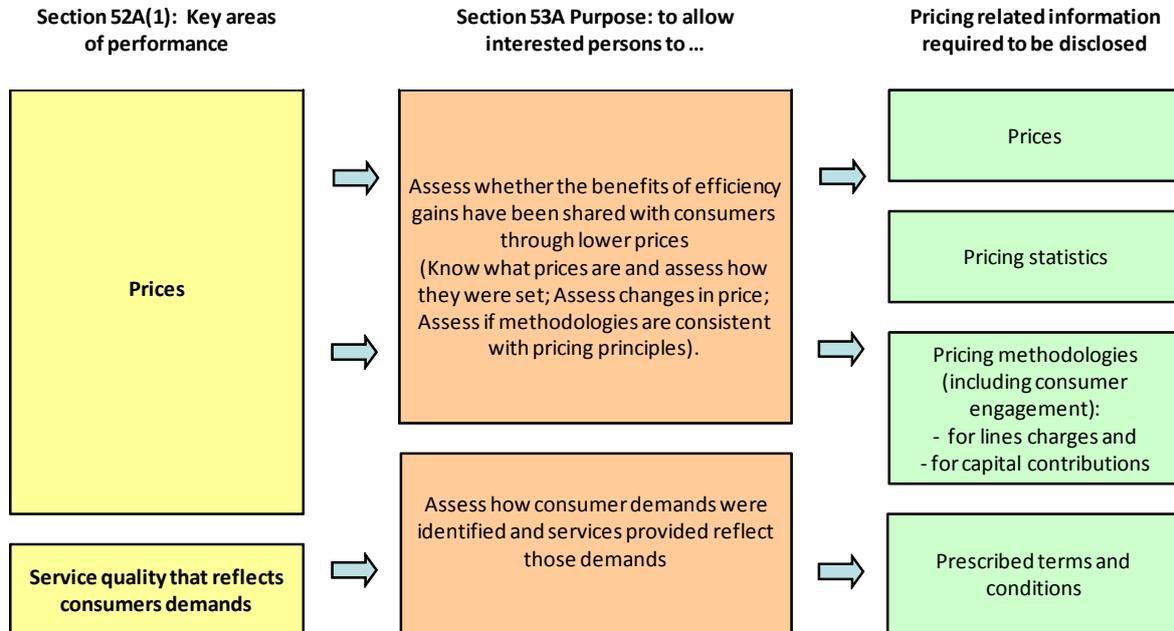
- 5.5 EDBs and GPBs receive income from several sources for which prices are set. These income sources include:
- 5.5.1 charges for the provision of lines / pipeline services
  - 5.5.2 capital contributions
  - 5.5.3 payments from providers of distributed generation.

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<sup>127</sup> Commerce Act 1986, s 53C(2)(c)-(d).

- 5.6 Pricing disclosures provide information to interested persons on the income suppliers receive from prices.<sup>128</sup>
- 5.7 Figure 5.1 summarises the links between the Part 4 Purpose and the pricing related information we consider should be disclosed.

**Figure 5.1 Our approach to disclosure of pricing and related information**



*The views of stakeholders on pricing disclosures*

- 5.8 In developing our draft ID Determinations, we informally approached a range of interested persons for their views on ID.<sup>129</sup> Of the various types of information disclosures, pricing information was the most frequently and intensively used type of information identified by the interested persons we met with. Notwithstanding this, interested persons identified a number of gaps in the pricing information that was available to them. Key information gaps included a lack of information on:

- 5.8.1 explanations for changes in prices over time
- 5.8.2 expected future prices
- 5.8.3 capital contributions – when they are charged and how the amount is determined.

<sup>128</sup> We invite interested persons to identify if there are any other sources of income from prices that we have not considered in paragraph 5.5.

<sup>129</sup> For example, we met with Gen-tailors (e.g. Genesis Energy, Contact Energy, Meridian), consumers and their representatives (e.g. Federated Farmers, Domestic Energy Users Network, NZ Defence Force, Fonterra), consultancies (e.g. Smartpower, Group Energy Purchase, Simply Energy). We also met with a number of suppliers through workshops in May and June, and with regulators and government departments (GIC, EA, MED).

- 5.9 Suppliers were concerned about the potential for inconsistency between the Commission's ID requirements and the EA's expectations for the disclosure of pricing methodologies.<sup>130</sup>
- 5.10 We have considered these views when developing our draft ID Determinations, so as to ensure that interested persons have sufficient information to assess whether the Part 4 Purpose is being met.

#### 5.4 Disclosures of pricing methodologies

- 5.11 Pricing methodologies describe the methodology suppliers use to set prices for their services. The disclosure of pricing methodologies assists interested persons to understand how prices are set.
- 5.12 Both EDBs and GPBs currently disclose pricing methodologies under the relevant current ID requirements.<sup>131</sup> Neither EDBs nor GPBs are required to adopt any specific pricing methodology. The methodologies therefore vary between suppliers.

##### *Input methodologies and pricing methodologies*

- 5.13 Section 52T(1)(b) of the Act states that IMs relating to particular goods or services must include pricing methodologies, to the extent applicable to the type of regulation under consideration, except where another industry regulator such as the EA has the power to set pricing methodologies in relation to a particular good or service.
- 5.14 Given the EA's responsibilities in respect of pricing methodologies for EDBs we set an IM for pricing methodologies for GPBs, but not for EDBs.<sup>132</sup>

##### *GPBs and pricing principles*

- 5.15 In the IM Reasons Paper we discussed the choices on the approach to pricing methodologies. We described the options as ranging from a light handed approach where suppliers have complete flexibility when setting their prices; to a heavy handed approach where the Commission would mandate a pricing methodology.<sup>133</sup> We opted for an intermediate approach – the principles-based approach.<sup>134</sup>
- 5.16 We explained that a principles-based approach to setting pricing methodologies was likely to promote allocative and, to a lesser extent, dynamic efficiency, and was

<sup>130</sup> See Commerce Commission, *Workshop 2: Pricing Disclosures 31 May 2011 - Workshop Final Minutes*, 30 July 2011, page 4, available on our website at [www.comcom.govt.nz/part-4-review-of-electricity-information-disclosure-requirements](http://www.comcom.govt.nz/part-4-review-of-electricity-information-disclosure-requirements)

<sup>131</sup> EDBs currently disclose pricing methodologies under Requirements 22 and 23 of Commerce Commission, *Electricity Information Disclosure Requirements*, 31 March 2004. GDBs currently disclose pricing methodologies under requirement 20 of the *Gas (Information Disclosure) Regulations 1997*.

<sup>132</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraphs 2.8.36 and 7.1.2.

<sup>133</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraphs 7.3.2.

<sup>134</sup> *Ibid.* Paragraph 7.3.2.

consistent with the Part 4 Purpose.<sup>135</sup> In the IM Reasons Paper we also discussed the insights from workably competitive markets for pricing methodologies and the principles of efficient pricing.<sup>136</sup> We signalled that information disclosure requirements were likely to require suppliers to demonstrate the extent to which their pricing methodologies are consistent with the pricing principles, and to explain any inconsistency.<sup>137</sup> This was supported by submitters.<sup>138</sup>

- 5.17 Our draft ID Determinations for GPBs therefore requires GPBs to demonstrate the extent to which their pricing methodology is consistent with the pricing principles we set in the Input Methodologies,<sup>139</sup> and to provide reasons for any inconsistency.

#### *Role of the EA and pricing principles*

- 5.18 The EA's approach to pricing methodologies for EDBs also adopts a principles-based approach, continuing work undertaken by its predecessor (the Electricity Commission).<sup>140</sup> The EA (and the Electricity Commission) has published pricing principles, ID guidelines for pricing methodologies and draft assessment criteria for assessing pricing methodologies.<sup>141</sup> These pricing principles for EDBs are very similar to those set by us for GPBs in the IMs.

- 5.19 The pricing principles were published by the Electricity Commission as part of work to encourage EDBs to structure their prices in a way that delivers economically efficient outcomes.<sup>142</sup> As such, and for similar reasons that we noted with respect to GPBs above in paragraph 5.16, we consider that a principles-based approach to the disclosure of pricing methodologies by EDBs, and the pricing principles published by the Electricity Commission, are consistent with the Part 4 Purpose.

- 5.20 For these reasons we therefore propose to incorporate the EA's pricing principles directly as part of our draft ID Determination for EDBs.<sup>143</sup> Specifically, our draft ID Determination for EDBs requires EDBs to demonstrate the extent to which their

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<sup>135</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraphs 7.3.8.

<sup>136</sup> *Ibid*, paragraph 7.2.1 to 7.2.9.

<sup>137</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraphs 7.3.3 and 7.3.10.

<sup>138</sup> *Ibid*, paragraph 7.3.10.

<sup>139</sup> Commerce Commission, *Input methodologies determination applicable to gas distribution services pursuant to part 4 of the Commerce Act 1986*, Subpart 5, clauses 2.5.1-2.

<sup>140</sup> See Electricity Authority, *Criteria for assessing alignment against the Information Disclosure Guidelines and Pricing Principles*, 5 September 2011, available on the EA's website at [www.ea.govt.nz](http://www.ea.govt.nz).

<sup>141</sup> See Electricity Commission, *Distribution Pricing Principles and Information Disclosure Guidelines*, February 2010, and Electricity Authority, *Criteria for assessing alignment against the Information Disclosure Guidelines and Pricing Principles*, 5 September 2011, both available on the EA's website at [www.ea.govt.nz](http://www.ea.govt.nz). The EA's pricing principles are reproduced in Attachment A2 to this paper.

<sup>142</sup> Electricity Commission, *Distribution Pricing Principles and Information Disclosure Guidelines*, February 2010, paragraph 2.1.1.

<sup>143</sup> For further information on the pricing principles and information disclosures guidelines developed by the EA, including criteria for assessing alignment, see Electricity Commission, *Distribution Pricing Principles and Information Disclosure Guidelines*, February 2010; see also Concept Consulting, *Assessment of selected distributors' alignment against the Information Disclosure Guidelines, and their consideration of the Pricing Principles*, 6 August 2011, available on the EA's website: [www.ea.govt.nz](http://www.ea.govt.nz).

pricing methodology is consistent with the relevant pricing principles as published by the EA, and to provide reasons for any inconsistency.

- 5.21 We have considered how best to implement this requirement in the draft ID Determination for EDBs. Under clause 2(1) of Schedule 5 of the Act, material may be incorporated into a s 52P determination by reference if the material deals with technical matters and it is impractical to include it in, or publish it as part of, the determination. We consider that the pricing principles qualify as a technical matter and that it is not impractical to include the EA's principles into the ID determination. As such, we have included the principles into the draft ID Determination for EDBs. This option allows for a convenient, user-friendly document. We have also liaised with the EA and will consult on whether to make further change to the ID Determinations if the EA changes its pricing principles. We seek submitters' views on the proposed approach.

*Views from interested persons on pricing methodologies and our response*

- 5.22 In the July 2009 Discussion Paper, we proposed to require EDBs and GPBs to disclose pricing methodologies under Part 4.<sup>144</sup> Submitters from both the electricity distribution and gas pipeline sectors generally considered that pricing methodologies should continue to be disclosed.<sup>145</sup>
- 5.23 Vector considered that disclosure should only be required when distributors have materially changed pricing structures and cost allocation methodologies – they should not automatically be required in cases where an annual disclosure simply reflects continuation of a supplier's existing methodology. Vector considered this would minimise transaction costs.<sup>146</sup>
- 5.24 We disagree that pricing methodologies should only be required if pricing structures or cost allocations materially change. Prices are typically set for a one year period (the pricing year). Disclosing an annual pricing methodology enables interested persons to assess prices each year, regardless of whether prices, cost allocations, or the methodology has changed. If the methodology has not changed, the pricing methodology for the following year should be very similar to that disclosed previously.
- 5.25 During our informal engagement process with interested persons,<sup>147</sup> a number of stakeholders stated that consumers need more information to both understand how prices have changed over time, and how they may change in future.

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<sup>144</sup> See Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009, at paragraph 482.

<sup>145</sup> See GasNet, *Submission on the Information Disclosure Discussion Paper*, 10 September 2009, at page 9; PwC, *Submission to Commerce Commission on the Information Disclosure Discussion Paper*, 11 September 2009, at page 19; and Vector Ltd., *Submission to Commerce Commission on the Information Disclosure Discussion Paper*, 11 September 2009, at page 22.

<sup>146</sup> Vector Ltd., *Submission to Commerce Commission on the Information Disclosure Discussion Paper*, 11 September 2009, paragraph 98.

<sup>147</sup> See paragraph 2.36.3 above.

- 5.26 We agree with this proposal and have included it in our draft ID Determinations.<sup>148</sup> It will enable an interested person to assess more easily whether a supplier is, over time, sharing efficiency gains with consumers through lower prices, and which consumers are enjoying those gains through lower prices. Price signals help encourage efficient consumption decisions, and information on longer-term price trends can further assist consumers to make efficient consumption decisions.
- 5.27 Accordingly we consider that suppliers should be required to explain reasons for changes in prices since the previous pricing methodology was disclosed, and to disclose their medium-term plan for future prices (in terms of the supplier's pricing strategy).
- 5.28 The ongoing development of pricing principles and ID guidelines by the EA was seen by pricing workshop attendees to be a positive step. Submitters highlighted the need for alignment between the Commission's ID requirements for EDBs and the EA's ID guidelines and pricing principles to avoid potential inconsistencies.
- 5.29 We agree with the desirability of aligning our and the EA's approach to pricing disclosures. We consider there is already strong alignment which is illustrated by our:
- 5.29.1 adoption of principles-based pricing methodologies
  - 5.29.2 adoption of a common set of pricing principles for EDBs (i.e., the EA's pricing principles) which is similar to the pricing principles specified for GPBs
  - 5.29.3 preference for a single pricing methodology disclosure to cover both the EA and our disclosure requirements for EDBs
  - 5.29.4 direct inclusion of the EA's pricing principles in our draft ID Determination for EDBs.
- 5.30 Reflecting this alignment, we anticipate that disclosure of a single pricing methodology annually by each EDB will meet both our ID requirements and the EA's requirements in respect of such disclosures. Disclosure of each supplier's pricing methodology in a single document has benefits to all interested persons, including suppliers.

*Other changes to pricing methodology requirements*

- 5.31 In addition to the changes discussed above we have made a number of other changes to the ID requirements to disclose pricing methodologies for both EDBs and GPBs. In particular, our draft ID Determinations require suppliers to disclose:
- 5.31.1 when and how they use non-standard contracts. This is discussed briefly below

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<sup>148</sup> Clause 5 of section 2.4 (pricing and related information), of each of the draft ID Determinations.

- 5.31.2 how they have treated payments (and credits) to and from distributed generators.<sup>149</sup> This is to ensure interested persons understand how payments to and from distributed generators affect the prices set for all consumers
- 5.31.3 if the supplier has engaged with consumers over its pricing methodology, how its pricing methodology reflects the expectations as to the quality and price of service of consumers.<sup>150</sup> If the supplier has not undertaken a consumer engagement process this should be stated in the pricing methodology, with an explanation as to why this has not occurred.

*Disclosures in pricing methodologies regarding non-standard contracts*

- 5.32 Suppliers have differing approaches to the use of non-standard contracts: some use them sparingly, while others have many non-standard contracts.<sup>151</sup> The extensive use of non-standard contracts could indicate a willingness to tailor terms and conditions for the specific needs of individual consumers (or small groups of consumers), or that the standard plans are not well suited for many users, among other possible explanations.
- 5.33 As prices for non-standard contracts may not be posted, and other terms and conditions may vary, it is generally more difficult for interested persons to compare standard and non-standard contracts, and to understand or assess the prices paid by different groups of consumers. We therefore consider it important for interested persons to understand the reasons why suppliers might prefer to use non-standard contracts.
- 5.34 Our draft decisions are that suppliers disclose, as part of their pricing methodology:
- 5.34.1 how suppliers determine when to use a non-standard contract, including any criteria for determining this
- 5.34.2 the extent of use of non-standard contracts, including the number of ICPs represented by non-standard contracts and the value of revenue anticipated from non-standard contracts
- 5.34.3 how prices for non-standard contracts are determined, and what specific criteria or methodologies are used for setting these prices, if any

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<sup>149</sup> Clause 6.3 of section 2.4 (pricing and related information), of f the draft EDB ID Determination.

<sup>150</sup> Clause 1.5 of section 2.4 (pricing and related information), of each of the draft ID Determinations.

<sup>151</sup> See the definitions of 'Standard contract' and 'Non-standard contract' within clause 3, section 1.4 (Interpretation) of the draft ID Determinations. A contract for electricity lines or gas pipelines is defined as a standard contract where:

- (a) the price at which the electricity lines or gas pipeline services are to be carried out under the contract is determined solely by reference to a publicly disclosed schedule of prescribed terms and conditions; and
- (b) at least four other persons each have such contracts with the supplier, and none of those other person is in a prescribed business relationship with the supplier, or with any of the other persons.

A non-standard contract is defined as any contract which is not a standard contract.

- 5.34.4 whether different terms and conditions to address risks and responsibilities in the event of an interruption to supply are being agreed with consumers on non-standard contracts, in comparison to those on standard contracts.<sup>152</sup>
- 5.35 Feedback from interested persons supported the provision of further transparency on approaches to non-standard contracts. At the pricing workshop, Simply Energy stated that there is little transparency around how non-standard contracts are determined and that consumers have little countervailing power when negotiating with suppliers.<sup>153</sup>
- 5.36 The disclosure of prescribed terms and conditions for all contracts (including non-standard contracts) is discussed in paragraphs 6.50 to 6.59 below.

## 5.5 Disclosure of the methodology for determining capital contributions

- 5.37 Capital contributions are charges received by a supplier from consumers for the provision of assets to provide or improve a connection. Under the asset valuation IM, capital contributions are netted off the value of RAB (under the current EDB disclosure requirements, they were treated as revenue).<sup>154</sup> The draft ID Determinations require disclosure of capital contributions, and how they are determined.<sup>155</sup>
- 5.38 Capital contributions are a significant source of income for many suppliers. Data disclosed under the current EDB requirements suggests that capital contributions revenue, in some cases, represents more than 15% of total regulatory income.<sup>156</sup>
- 5.39 At the pricing workshop and in informal meetings, several interested persons commented that the amount of information available was insufficient to understand when capital contributions are sought and how they are calculated. For example, Simply Energy noted that it is not clear how capital contributions are determined,<sup>157</sup> and that some consumers do not have enough information to verify if the capital contributions they pay:
- 5.39.1 properly reflect the actual costs to suppliers of the additional assets or line extensions required

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<sup>152</sup> Clause 6 of section 2.4 (pricing and related information), of each of the draft ID Determinations.

<sup>153</sup> See Commerce Commission, *Workshop 2: Pricing Disclosures 31 May 2011 - Workshop Final Minutes*, 30 July 2011, page 4.

<sup>154</sup> For discussion see Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, Appendix E, paragraphs E7.1 to E7.5.

<sup>155</sup> Clause 7 of section 2.4 (pricing and related information), of each of the draft ID Determinations.

<sup>156</sup> For nearly a third of EDBs in the previous three disclosure years, capital contributions represented more than 10% of total regulatory income in a single disclosure year. For example, according to our own analysis, Buller Electricity's disclosure for YE 2010 indicated that capital contributions revenue represented 15.1% of total regulatory income; Network Waitaki's capital contributions represented more than 10% of total regulatory income in both 2008 and 2009.

<sup>157</sup> See Commerce Commission, *Workshop 2: Pricing Disclosures 31 May 2011 - Workshop Final Minutes*, 30 July 2011, page 4.

- 5.39.2 reflect the extent to which they are being asked to contribute towards the cost of shared assets
- 5.39.3 are comparable to those levied to other consumers with similar load (or other) characteristics.
- 5.40 Consumers may have little power to negotiate these charges, have few if any alternatives (or alternative suppliers) to consider, and face considerable commercial risk in delaying acceptance of the suppliers' terms (e.g. a developer exposed to the prospect of liquidated damages).<sup>158</sup>
- 5.41 We note that some suppliers already publish information on what capital contributions will be required, publish standard schedules of capital contributions, and provide information on how these are determined.<sup>159</sup> Other suppliers do not. As a result, some interested persons do not currently have sufficient information to understand when they are required to pay a capital contribution, how the amount of a capital contribution is determined, and what services they are buying for their capital contribution.
- 5.42 To address this information imbalance, we propose that suppliers should be required to:
- 5.42.1 explain the circumstances under which they seek capital contributions
- 5.42.2 disclose any methodology for determining the amount of a capital contribution
- 5.42.3 explain the extent of consistency of the pricing methodology for capital contributions with the relevant pricing principles (as set by the EA for EDBs, or by us for GPBs)<sup>160</sup>
- 5.42.4 disclose a statement of whether consumers can use an independent contractor to undertake some or all of the work covered by the capital contribution
- 5.42.5 disclose their schedule of standard capital contribution charges (if such a schedule exists)
- 5.42.6 when a person queries the amount of the capital contribution being sought, (and when the charge is not covered in the schedule of standard capital

<sup>158</sup> See points made by Simply Energy in Commerce Commission, *Workshop 2: Pricing Disclosures 31 May 2011 - Workshop Final Minutes*, 30 July 2011, page 5.

<sup>159</sup> For example, Orion NZ Ltd. and Aurora Energy Ltd. already publish capital contributions schedules and related information on their websites. See [www.oriongroup.co.nz](http://www.oriongroup.co.nz), and [www.electricity.co.nz](http://www.electricity.co.nz) (Aurora).

<sup>160</sup> For EDBs we consider that the EA pricing principles most relevant to capital contributions policies are (a), (c) and (d), as reflected in the accompanying Draft ID Determination for EDBs. See Electricity Commission, *Distribution Pricing Principles and Information Disclosure Guidelines*, February 2010, available at [www.ea.govt.nz](http://www.ea.govt.nz). For GPBs, we consider that the relevant pricing principles are (1), (3) and (4) as reflected in the accompanying Draft ID Determination for GPBs. See *Commerce Act (Gas Distribution Services Input Methodologies) Determination 2010*, subpart 5, clause 2.5.2.

contribution charges, or no such schedule exists) to provide reasonable explanation to that person of the components of that amount and how these were determined.<sup>161</sup>

## 5.6 Disclosure of prices

- 5.43 Prices reflect the amount charged to consumers for the provision of electricity lines and gas pipeline services. We propose to continue current requirements to disclose prices (previously line charges), with changes to content and timing to reflect feedback from interested persons.
- 5.44 We asked attendees at the pricing disclosures workshop how current line charge disclosure requirements could be improved to enhance their usefulness. Attendees considered that the current requirements to disclose in newspapers were outdated and expensive.<sup>162</sup> Vector noted the required timing of EDB line charge disclosures caused difficulty due to their internal sign-off and verification procedures.<sup>163</sup>
- 5.45 In response to suppliers concerns, we consider it important that reasonable steps should be taken to advise consumers of changes in their prices. We therefore propose to retain the newspaper disclosure requirement, but require only disclosure of the new price(s) compared with previously applicable prices, and the contact details (including the supplier's website) where further details of the price change may be found.
- 5.46 We also propose a summary disclosure requirement, where suppliers would disclose a summary of all new prices payable by four or fewer consumers introduced during that disclosure year, after the end of each disclosure year.<sup>164</sup> This would replace the current EDB requirement to disclose prices at the time they are entered into. This is intended to make it easier to comply with the requirements.

## 5.7 Disclosure of prescribed terms and conditions of contracts

- 5.47 EDBs and GPBs are currently required to publicly disclose information concerning prescribed terms and conditions of standard and non-standard contracts (and 'prescribed agreements', in the case of GPBs). We propose to continue this requirement, except that:
- 5.47.1 in respect of non-standard contracts, disclosure of the full prescribed terms and conditions is required only upon request

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<sup>161</sup> Clause 7 of section 2.4 (pricing and related information), of each of the draft ID Determinations.

<sup>162</sup> Commerce Commission, *Workshop 2: Pricing Disclosures 31 May 2011 Workshop Final Minutes*, 30 July 2011, page 5.

<sup>163</sup> Commerce Commission, *Workshop 2: Pricing Disclosures 31 May 2011 Workshop Final Minutes*, 30 July 2011, page 5.

<sup>164</sup> Clause 18 of section 2.4 (Pricing and related information) of the draft EDB and GDB ID Determinations.

- 5.47.2 a new prescribed term is proposed which addresses terms and conditions regarding risk, responsibilities and liabilities in the event of an interruption to the supply of services.<sup>165</sup>
- 5.48 Disclosure of the terms and conditions of contracts for the supply of electricity lines or gas pipeline services provides a means of assessing whether the price and non-price terms and conditions of such contracts are consistent with the terms and conditions of contracts agreed in a workably competitive market. It enables interested persons to compare the terms and conditions offered to different consumer groups by that supplier (and for a consumer to enquire in an informed manner if better terms and conditions can be agreed<sup>166</sup>).
- 5.49 The disclosure of contractual terms and conditions can help interested persons understand how prices are set, whether prices reflect the sharing of efficiency gains with consumers, how risks are shared between suppliers and consumers, and whether prices reflect the supply of services at a quality demanded by consumers.
- 5.50 A comprehensive assessment of these matters may require the disclosure of all (or most) contractual terms and conditions.<sup>167</sup> Requiring this level of disclosure may be burdensome, relative to the actual use of such information by interested persons, so the draft ID requirements only require the public disclosure of prescribed terms and conditions.
- 5.51 The current requirements for EDBs and GPBs to disclose prescribed terms and conditions of contracts call for disclosure of terms that describe the services provided, and terms related to the price, timing of payment and security of payment.
- 5.52 In addition to these terms and conditions, we consider that interested persons should also be informed about contractual terms on reliability of service and liability in the event of such interruptions. These terms reflect the provision of services at a quality that reflects consumer demands (s.52A(1)(b)) and potentially affect the price paid for services.
- 5.53 We therefore propose disclosure of additional prescribed terms and conditions on the terms of liability in the event of interruptions to supply. To comply with s 53C(4), the proposed requirement to disclose these new prescribed terms and conditions will apply only to:

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<sup>165</sup> The definition of prescribed contracts in the current EDB ID requirements and prescribed agreement in the GIDR includes reference to 'related services' and persons 'involved' with an EDB or in a 'prescribed business relationship' with a GPB. We use the term 'involved in' in all draft ID Determinations. This is based on the definition of that term in the s.74 of the Electricity Industry Act, and ensures consistency between the EDBs and GPBs. An alternate approach would have been to continue to use the term 'prescribed business relationship' for GPBs (ie, from the GIDRs). We invite submissions on the whether or not that represents a more appropriate approach for GPBs to that in our draft ID Determinations.

<sup>166</sup> Note this latter point only partly replicates the ability of consumers of goods and services sold in workably competitive markets to compare terms and conditions of goods sold by competing suppliers, and to select the offer with the terms and conditions which best suit that consumer.

<sup>167</sup> We note s. 53C(2) does provide for the disclosure of contracts.

- 5.53.1 new contracts entered into after electricity lines and gas pipeline services became subject to information disclosure regulation<sup>168</sup>
- 5.53.2 existing contracts modified after the draft ID Determination is finalised.<sup>169</sup>
- 5.54 The EA has recently introduced amendments to the Code that, among other things, requires distributors to indemnify retailers in respect of liability under the Consumer Guarantees Act 1993 for certain breaches.<sup>170</sup> In our view, such changes underline the importance to interested persons of contractual terms regarding risks and responsibilities in the event of supply failures. Our proposed amendments complement the changes to the Code by also requiring the disclosure of provisions concerning risk and liability in all prescribed contracts, including non-standard contracts.
- 5.55 At the pricing workshop, Simply Energy stated that consumers on non-standard contracts should be able to compare what they are being offered with the most readily applicable standard contract option.<sup>171</sup> Simply Energy proposed disclosure of the 'standard' services (including standard asset configuration and service levels) applicable to each standard pricing consumer group.<sup>172</sup> This would enable consumers to assess the non-price terms of a non-standard contract against the non-price terms of standard contracts.
- 5.56 We recognise that this could be useful for consumers to be able to make this comparison (and that such comparisons are consistent with outcomes in workably competitive markets). However we consider that further work is needed to identify what 'standard services' or a 'standard asset configuration' mean in practice for each consumer group used to set prices, and how this might best be disclosed. We invite submissions on whether a requirement to disclose such information would be useful in practice, and how such a requirement could be designed to provide meaningful information for interested persons to make such assessments.

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<sup>168</sup> EDBs became subject to information disclosure regulation under Part 4 on 1 April 2009. GPBs became subject to information disclosure regulation under Part 4 on 14 October 2008 (refer Commerce Amendment Act 2008).

<sup>169</sup> Section 53C(4) provides that a s 52P determination may not require a supplier to publicly disclose any provision of an existing contract that, immediately before the goods or services became subject to information disclosure regulation, was not required by or under Part 4A (being Part 4A of the Act as in force immediately before its repeal by the Commerce Amendment Act 2008) or any other enactment, to be publicly disclosed.

<sup>170</sup> Electricity Authority, *Electricity Industry Participation (Distributor Use-of-System Agreements and Distributor Tariffs) Code Amendment 2011*, 26 October 2011.

<sup>171</sup> Consumers of services sold in workably competitive markets can compare more than one offer, and choose between them.

<sup>172</sup> See Commerce Commission, *Workshop 2: Pricing Disclosures 31 May 2011 - Workshop Final Minutes*, 30 July 2011, page 4.

*Public disclosure of the existence of contracts and disclosure of terms and conditions on request*

- 5.57 In earlier consultations on contract disclosures by EDBs, submissions tended to agree with the need to disclose contracts.<sup>173</sup> However, suppliers questioned the requirements to disclose the terms and conditions of individual contracts, noting that nobody has ever requested this information.<sup>174</sup> We understand that some interested persons have requested prescribed contracts for GPBs.
- 5.58 Public disclosure of the prescribed terms and conditions in standard contracts can be achieved simply by disclosing a single set of standard terms and conditions.<sup>175</sup>
- 5.59 While we consider the disclosure of contract terms and conditions to be useful for the reasons above, we recognise that public disclosure of material that is not well used may not be cost-effective.<sup>176</sup> We therefore reduced the scope of the obligation to disclose publicly the prescribed terms and conditions of non-standard contracts relative to that in the current ID requirements. A requirement to disclose some prescribed terms and conditions is maintained so that interested persons are aware that a non-standard contract has been entered into. An interested person could then consider requesting the remaining prescribed terms and conditions.
- 5.60 Our draft ID Determinations propose that EDBs and GPBs be required, in relation to non-standard contracts, to:
- 5.60.1 publicly disclose, at the time the new non-standard contract is entered into, a description of the goods or services to be supplied under the contract and the estimated value of those services
- 5.60.2 make available the prescribed terms and conditions of non-standard contracts on request only.<sup>177</sup>

## **5.8 Pricing statistics disclosure**

- 5.61 Pricing statistics capture historical (actual) revenues and average prices from different groups of consumers. Pricing statistics assist interested persons to compare (between consumer groups and over time) revenue earned from consumer groups. This, in turn, allows interested persons to assess whether the actual prices paid by different consumer groups reflect posted prices, and whether prices reflect improvements in efficiency over time and how these are allocated among consumer groups (relevant to s 52A(1)(c)).

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<sup>173</sup> In our October 2008 Information Disclosure Companion Paper, we noted that previous submissions tended to agree with the need to disclose contracts and did not raise any specific objections concerning the content of provisions regarding contracts. See Commerce Commission, *Information Disclosure Regime – Companion Paper to the Revised Information Disclosure Requirements*, 31 October 2008, paragraph 547.

<sup>174</sup> Commerce Commission, *Workshop 2: Pricing Disclosures 31 May 2011 - Workshop Minutes*, page 6.

<sup>175</sup> See clause 15 of section 2.4 of each of the draft ID Determinations.

<sup>176</sup> Even if such contracts are not used, the requirement to publicly disclose such contracts may have some deterrent effect on the exercise of monopoly power.

<sup>177</sup> See clauses 10 and 11 of section 2.4 of each of the draft ID Determinations.

- 5.62 We propose to continue to require a pricing statistics disclosure for EDBs, with changes to enhance their usefulness as a basis for making comparisons. Pricing statistics are to apply to prices set for both standard and non-standard contracts.
- 5.63 GPBs are not currently required to disclose pricing statistics. We propose introducing pricing statistics disclosures for GPBs, for the reasons discussed above.

*Commission's initial proposals and feedback from submitters*

- 5.64 In the July 2009 Discussion Paper we proposed the disclosure of pricing statistics by EDBs and GPBs, in a format consistent with current EDB requirements.<sup>178</sup> The current EDB requirements include disclosure of pricing statistics by four connection point classes: "small", "medium", "large" and "largest 5" connection points. Suppliers need to separately disclose components (income, volume, number of connection points) for each connection point class that are then used by the disclosure template to calculate unit price and relative unit price index ratios.
- 5.65 Submitters on the discussion paper and attendees at the pricing disclosures workshop considered that pricing statistics disclosures in the current requirements were not useful.<sup>179</sup> Workshop attendees considered that the calculated ratios do not provide meaningful data for analysis.<sup>180</sup> We agree. Also EDBs that use GXP-based pricing have difficulty complying with the current requirements.<sup>181</sup> This limits the comparability of pricing statistics across suppliers and between networks.

*Changes to pricing statistics requirements*

- 5.66 We note the concerns of suppliers, and issues of comparability and usefulness of the current EDB requirements. The 'connection point class' categories defined in the current EDB requirements do not necessarily match the consumer groups used by suppliers. This results in the loss of some information (as a potentially large number of consumer groups used by a supplier are subsumed within a single classification specified in the requirements). Further, suppliers using GXP pricing are unable to fully comply with the current requirements in a cost-effective manner.
- 5.67 The draft EDB ID Determination proposes the following changes to pricing statistics requirements in the current EDB ID requirements:

5.67.1 removal of unit price index ratios

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<sup>178</sup> See Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009, page 134.

<sup>179</sup> According to GasNet, pricing statistics cannot be specified in a meaningful way without considerable compliance costs, and other pricing disclosures are sufficient. See GasNet, *Submission on the information Disclosure Discussion Paper*, 10 September 2009, p.9; and PWC, *Submission on the information Disclosure Discussion Paper*, 11 September 2009, paragraph 58.

<sup>180</sup> Commerce Commission, *Workshop 2: Pricing Disclosures 31 May 2011 Workshop Final Minutes*, 30 July 2011, page 5.

<sup>181</sup> Powerco note that they do not hold billing information on the pricing breakdown required for their 0-100 KvA customers by ICP, making conversion to the Commission's consumer groupings ('connection point classes' in the current requirements) difficult. See *Workshop 2: Pricing Disclosures 31 May 2011 Workshop Final Minutes*, 30 July 2011, pages 5-6.

- 5.67.2 replacement of the prescribed connection point classes with disclosure of the consumer groups suppliers themselves use to set prices<sup>182</sup>
  - 5.67.3 line charge revenue to be disclosed by standard and non-standard consumer groups, and charge type, to enhance comparability between consumer groups and to increase usefulness for analysis
  - 5.67.4 disclosure of capital contributions revenue received, by consumer group
  - 5.67.5 optional commentary on pricing statistics, so suppliers can explain specific circumstances that are relevant to the disclosure, such as differences in prices between consumer groups.
- 5.68 The draft ID Determinations also propose the introduction of pricing statistics disclosures for GDBs. GDB pricing statistics disclosure requirements are very similar to those for EDBs, given they serve the same purpose.

*Pricing statistics disclosures for GTBs*

- 5.69 For GTBs, we propose disclosure of revenue, prices and capital contributions for each delivery point on the supplier's gas transmission network. For Maui Development Ltd this would include disclosure of their 'Price A' and 'Price B' by delivery gate; for Vector Transmission this would include capacity reservation fees, throughput fees, overruns, and any other charges by delivery gate.
- 5.70 Posted prices are already available for many delivery points on suppliers' websites, but prices under any non-standard contracts are typically not posted. As a result, interested persons do not know what each consumer on a pipeline is contributing to recover the cost of that pipeline. To help an interested person to understand the extent of any price differences or assess whether they are justified (by, for example, differences in cost, or peak demand usage) disclosure of prices and revenues contributed by all users of that pipeline is necessary.
- 5.71 There are several options for the disclosure by GTBs of pricing statistics, in relation to users paying non-posted prices. For example:
  - 5.71.1 Option 1- they could be publicly disclosed along with the pricing statistics for all users on posted prices
  - 5.71.2 Option 2 - they could be disclosed only to the Commission (and not disclosed publicly)
  - 5.71.3 Option 3 - they could be aggregated in some way (for example, by pipeline, or by zone).

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<sup>182</sup> Under the draft ID Determinations the consumer groups disclosed are required to be consistent with the consumer groups described in suppliers' pricing methodologies. See schedule 13 and the definition of consumer group in each draft ID Determination.

- 5.72 If this data is too aggregated (option 3) this reduces an interested persons' ability to compare pricing statistics, including between non-standard contracts, and between standard and non-standard contracts.
- 5.73 Option 2 (disclosure only to the Commission) could be used to maintain the confidentiality of the price agreed between a consumer and a supplier. However, given the high level of shared assets and costs, it can be argued that public disclosure of the revenue contributed by each user is necessary for interested persons (including other users) to assess the efficiency of the prices. We consider that this outweighs an individual party's possible reasons for keeping its prices confidential.
- 5.74 Our preference for GTB pricing statistics disclosure is therefore option 1. Public disclosure of this information enables all interested persons to be informed and to make comparisons of prices for all users. The pricing statistics disclosure (Schedule 13 in each of the draft ID Determinations) seeks aggregated information on average actual payments made and volumes supplied each disclosure year – it does not seek the disclosure of provisions of individual contracts.<sup>183</sup>
- 5.75 We propose to retain disclosure using standard templates, as it provides an easy-to-use format that promotes data consistency and assists effective analysis.

### **5.9 Disclosure of pricing information by sub-network**

- 5.76 The current EDB ID requirements call for disclosure of certain pricing, performance and network information in respect of:
- 5.76.1 geographically non-contiguous networks (as defined in the current EDB requirements)
  - 5.76.2 a distribution business which is consumer-controlled and the number of controlling consumers is less than 90% of the total number of consumers.
- 5.77 As discussed in paragraphs 4.95-4.99, we propose a new definition of 'sub-networks'. Our draft ID Determinations require pricing statistics to be disclosed by sub-network (where applicable). This is to enable interested persons to assess differences in price between sub-networks (for example, for non-controlling consumers to compare the prices they pay against the prices paid by the controlling consumers).

### **5.10 Disclosure of discretionary discounts and rebates arising from ownership interest**

- 5.78 EDBs that are partly or fully owned by consumers<sup>184</sup> may pay a rebate or a discretionary discount to their consumers, which may take a variety of forms. Such discounts form part of the total price paid by consumers for the provision of electricity lines services. An assessment of entitlements to such discounts therefore

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<sup>183</sup> As such, we consider it complies with s.53C(4) of the Act which precludes us from requiring a supplier to publicly disclose any provision of an existing contract that, immediately before the goods or services became subject to information disclosure regulation, was not required by or under Part 4A (as defined in section 54B) or any other enactment to be publicly disclosed was not previously required to be disclosed.

<sup>184</sup> This includes (but is not limited to) those EDBs that meet the definition of 'Consumer owned' in s 54D of the Act. Consumer-ownership is not currently a characteristic of GPBs.

forms part of any assessment of prices, and the comparisons of prices paid across consumer groups and over time. As such, consumers (and other interested persons) should have information on their entitlement to discounts as they have information on other elements of the total price. Consumers in workably competitive markets also have information on the total price, reflecting any rebates or discounts, so they can verify that the price they have been charged for a good or service is correct.

- 5.79 Smartpower, an energy consultancy we met with in our informal engagement, advised us that their clients were unable to determine, from the information available, whether they were receiving the correct entitlement to discretionary discounts. As a result, for example, they could not compare the discount or rebate received against their entitlement.
- 5.80 Our draft ID Determinations require EDBs to disclose, at the time distributions are made, their methodology for determining what discounts consumers are entitled (including rebates). This will allow consumers to check they have received the discount or rebate they were entitled to.

### **5.11 Disclosure of specific policies proposed in 2009**

- 5.81 In the July 2009 Discussion Paper we suggested that regulated suppliers may be required to disclose policies related to:
- 5.81.1 credit
  - 5.81.2 delegated authority
  - 5.81.3 profit distribution
  - 5.81.4 sponsorship.<sup>185</sup>
- 5.82 Submitters disagreed with these proposed requirements, stating that disclosures are potentially onerous, are difficult to link to the Part 4 Purpose, and are concerned with business decision-specific areas that will not contribute to assessments of the whether the Part 4 Purpose is being met.<sup>186</sup> In general we agree, and also consider that the compliance costs of these disclosures in most cases may outweigh the potential benefits of such disclosures.
- 5.83 Accordingly, our draft decision is that information relating to these policies is not required to be disclosed.<sup>187</sup>

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<sup>185</sup> Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009, page 109, paragraphs 495-501. The July 2009 Discussion Paper also discussed the disclosure of insurance policies. The disclosure of arrangements concerning the insurance of assets is discussed further in paragraph 3.51 (self-insurance expenses for determining regulatory profit) and paragraph 4.92.8 (disclosure of insurance arrangements).

<sup>186</sup> For example, see Vector Ltd., *Submission to Commerce Commission on the Information Disclosure Discussion Paper*, 11 September 2009, page 30 and paragraphs 103-105, and answer to question 69.

<sup>187</sup> This draft decision is consistent with the decision taken for the Airports sector. See Commerce Commission, *Information Disclosure (Airport Services) Reasons Paper*, 22 December 2010, paragraph 6.36.

## 5.12 Transitional provisions

- 5.84 We have provided for transitional provisions that adjust the application of some disclosure requirements for an initial period after the commencement of ID regulation under Part 4.
- 5.85 For pricing disclosures the draft transitional provisions propose that:
- 5.85.1 For EDB pricing methodologies, sub-clauses 1.1(4)(c) and (d) (which relate to changes in prices over time) of the draft ID Determinations require a comparison between target revenue disclosed (if applicable) for the current disclosure year and any target revenue disclosed for the previous disclosure year. For the initial pricing methodology disclosure under the new requirements only, EDBs are to compare the target revenue (if applicable) to the revenue required to be disclosed in accordance with Requirement 23(b) of the current EDB requirements.
  - 5.85.2 GPBs are not required to comply with sub-clauses 1.1(4)(c) and (d) of the draft ID Determinations for the initial disclosure year (from 1 October 2012).
- 5.86 The specific timing of pricing disclosures is further discussed in Chapter 6.

## Chapter 6: Verification, Publication, Timing and Transitional Provisions

Description	<p>Interested persons must be able to rely on disclosed information being prepared in accordance with the ID Determination.</p> <p>Disclosed information needs to be:</p> <ul style="list-style-type: none"> <li>• reliable to confidently assess whether the purpose of Part 4 is being met.</li> <li>• readily available (published).</li> </ul> <p>Section 53C(3) provides for information to be verified by statutory declaration or audit.</p>
Main change proposed to audit and verification requirements for EDBs and GPBs	<p>Statutory declarations, previously required to be furnished with disclosures, are not required.</p>
Publication of information requirements	<p>Proposed transition and timing arrangements include:</p> <ul style="list-style-type: none"> <li>• For EDBs the disclosure year will continue to be year ended 31 March</li> <li>• For GPBs the disclosure year will be aligned with default price-quality compliance periods – year ending 30 September.</li> </ul> <p>The initial disclosure year under the draft ID Determinations will be the year ended :</p> <ul style="list-style-type: none"> <li>• 2012 for historic information (disclosures required in 2012)</li> <li>• 2013 for forecast information (disclosures required in 2012)</li> </ul> <p>Transitional provisions are provided for to ensure information required in transitioning from the previous information disclosure requirements is available.</p>

Verification Requirements	<p>All disclosures except prices and /or prescribed terms and conditions require director certification</p> <p>Disclosures of historic financial and non-financial information are required to be audited</p>
References in draft ID Determinations	<p>Sections 2.6 - Auditor's Reports 2.7 - Certificates 2.8 - Retention and Continuing Disclosures 2.9 - Exemptions 2.10 – Transitional Provisions</p> <p>Schedules 22-24 (EDBs) and Schedules 21 to 23 (GDBs and GTBs)</p>

## 6.1 Introduction

6.1 This chapter outlines the reasons for our draft decisions related to the verification, certification, audit and publication of disclosed information for EDBs and GPBs. It also outlines our reasons for when the disclosures are made and the transitional provisions for the initial disclosures.

6.2 This chapter discusses:

- 6.2.1 the purpose and approach to verification (section 6.2)
- 6.2.2 types of verification considered (section 6.3)
- 6.2.3 director certification including statutory declarations (section 6.4)
- 6.2.4 audit requirements (section 6.5)
- 6.2.5 publication and retention of information (section 6.6)
- 6.2.6 the disclosure period and the initial disclosure year (section 6.7)
- 6.2.7 transitional provisions (section 6.8).

## 6.2 Purpose and approach to verification

6.3 Section 53C(3) of the Act provides that a s 52P determination may require information to be verified by statutory declaration or audit. Under section 53C(3)(f) we may impose any other requirements that we consider necessary or desirable to promote the purpose of information disclosure regulation. We interpret this provision as enabling us to require other forms of verification, if doing so promotes the purpose of information disclosure.

6.4 Interested persons, including the Commission, need assurance that disclosed information has been prepared in accordance with the determination, to have confidence in their assessments of whether the purpose of Part 4 is being met. In setting the verification provisions we have sought to balance the need for assurance

that the disclosed information complies with the requirements and the costs incurred in providing that assurance.

### **6.3 Types of verification considered**

- 6.5 There is a range of options available that provide assurance that information is reliable including:
- 6.5.1 director certifications
  - 6.5.2 statutory declarations
  - 6.5.3 audit reports
  - 6.5.4 expert opinions
  - 6.5.5 Commission review of disclosures.
- 6.6 Director certification can be a relatively cost-effective means of gaining assurance as it is expected that directors would be able to certify information given their knowledge of the business, and their role. We expect that directors will seek whatever advice they consider is needed prior to signing the director certificate, which may include senior executive or external advice.
- 6.7 Statutory declarations are a stronger form of certification owing to the sanctions that apply should a false declaration be given. The draft ID Determination does not require statutory declarations but, rather, intends to rely upon the assurance provided by director certifications. We propose that the statutory declarations in the current ID requirements and in the GIDRs will not be included in the proposed ID Determinations.
- 6.8 In some instances it is more appropriate to have a third party certify that information. This form of assurance, however, does have its limitations and can be costly. The cost of gaining certification increases with the level of certification required. For example, audits generally do not provide assurance on the appropriateness of assumptions used in prospective information. However, an audit may be used to provide assurance that information has been properly compiled on the basis of assumptions provided, rather than to assert any opinion on the accuracy or reasonableness of forecasts. Accordingly, audit opinions are reserved for disclosures upon which we require a high level of assurance.
- 6.9 Expert opinions are valuable in seeking independent assurance in areas requiring specific expertise where an auditor may not be qualified. Generally speaking an audit opinion is preferred over an expert opinion due to the reliance that can be placed on the standard to which an audit opinion is provided. However, in some instances auditing standards or the expertise of auditors may limit the ability of an auditor to provide the required assurance on particular information. In such cases it may be necessary for an expert opinion to be required rather than an audit opinion. Financial auditors can, however, engage experts to supplement their areas of

expertise so that they have the skill set available to complete the audit of disclosures as an alternative to suppliers requiring supplementary expert opinions.

- 6.10 We do not propose to require expert opinions in the draft ID Determinations.
- 6.11 Section 103 of the Act provides assurance of accurate disclosures by providing for penalties where a party knowingly provides false or misleading information to us. Sections 86 and 86B of the Act also provide for penalties for breaching the ID Requirements. We have the ability to monitor information under s 53B(2)(a) of the Act and are required to publish a summary and analysis of that information. As part of this process we may seek to further verify any information included in that summary and analysis.
- 6.12 Table 6.1 below summarises the provisions of the draft ID Determination relating to verification of required disclosures. The disclosures are categorised consistent with the nature of their underlying information and summarises the form of assurance required in the draft ID Determinations.

**Table 6.1: Draft ID Determinations – Summary of assurance provisions**

<b>Disclosure category</b>	<b>Characteristics</b>	<b>Verification</b>
Historical financial information Report on return on investment Report on regulatory profit Report on the regulatory tax allowance Report on TCSD allowance Report on expenditure Report on the regulatory asset base roll-forward Report on actual to forecast expenditure Report on related party transactions Report on asset allocation Report on cost allocation Report supporting asset allocations Report supporting cost allocation Report on transitional financial information Asset allocation process	Significant reliance on information by interested persons  Source data is easily verified	Audited  Director certified  Reviewed by Commission (s.53B(2)(a))
Historical non-financial information Report on pricing statistics GDB pipeline peak offtake report Disclosure of GTB pipeline capacity Network driver report Network performance report	High degree of reliance on information  Difficult to verify source data	Audited – verified to source data only  Director certified  Reviewed by Commission (s53B(2)(a))

Disclosure category	Characteristics	Verification
Asset management information  AMP update report Network asset AMP report Network driver AMP report Network expenditure AMP report AMMAT report Pricing methodology	High degree of reliance on information  Type of information to be disclosed information, including prospective non-financial information, may be outside the competence of financial auditors  Costly to audit, relate to assurance that an audit provides	Director certified  Reviewed by Commission under monitoring provision (s53B(2)(a))
Other information  Line charges Other pricing information	Derived from pricing methodology	Not required to be audited/ director certified

6.13 In determining the appropriate level of assurance we have considered the underlying characteristics of the information, the availability of supporting records, the cost of providing the various forms of assurance and the level of reliance placed on the information.

6.14 The next section outlines submitters' feedback on verification requirements, and our response to those submissions.

#### 6.4 Director certification and statutory declarations

6.15 The draft ID Determinations provide that:

6.15.1 for all disclosures, directors must certify that, having made all reasonable enquiry, to the best of their knowledge the information complies, in all material respects, with the relevant requirements

6.15.2 director certificates must be signed by two directors and attached to the disclosures when disclosure is made, including internet publication.

6.16 We have included the wording 'in all material respects' to the certification of disclosures by directors. This introduces a materiality threshold to the certification recognising that we are primarily concerned with material, not trivial, breaches. This approach is consistent with the approach proposed in our recently released

consultation paper relating to a proposed amendment of the Specified Airport Services ID Determination.<sup>188</sup>

- 6.17 We propose that directors be required to certify the transaction value of related party transactions as outlined in paragraphs A1.50 to A1.54.
- 6.18 We had previously proposed a requirement that directors certify that the AMP describes the actual processes and practises implemented by the business.<sup>189</sup> Our draft ID Determinations do not require such certification. Rather, the AMMAT report, discussed in Chapter 4,<sup>190</sup> will provide additional information on the maturity of the processes and practices adopted by the business.
- 6.19 We had previously proposed a requirement that directors certify that the pricing methodologies disclosed were used by suppliers in setting prices.<sup>191</sup> The draft ID Determinations do not incorporate this proposal. We think a separate certification is unnecessary if the requirements relating to pricing methodologies include that the pricing methodology disclosed must be that used to set prices.
- 6.20 The draft ID Determinations do not require statutory declarations. Orion New Zealand Limited (Orion) submitted that the Commission should rationalise the requirements around director certification, advising that requiring some to be sworn is unnecessary.<sup>192</sup> We agree and the current requirements for statutory declarations are not continued or carried over from the GIDRs.

## 6.5 Audit requirements

- 6.21 The draft ID Determinations provide that:
- 6.21.1 historical financial and historical non-financial disclosures are to be audited
  - 6.21.2 the prospective information component of the financial and non-financial disclosures is audited to ensure:
    - (a) it is presented on a basis consistent with the regulatory accounting or technical measurement requirements used for disclosures for the current financial year and the immediately preceding financial year

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<sup>188</sup> Commerce Commission, *Draft Commerce Act (Specified Airport Services Information Disclosure) Amendment 2010 – Consultation Paper*, 19 December 2011, page 4.

<sup>189</sup> Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009, page 116.

<sup>190</sup> See paragraphs 4.84 - 4.92 in this paper. The requirement on the regulated companies to disclose a set of asset management maturity assessment scores (ie, AMMAT scores) provides a common framework by which the regulated businesses disclose the maturity of their asset management systems, including plan development and implementation.

<sup>191</sup> Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009, page 116.

<sup>192</sup> Orion, *Submission on Information Disclosure Discussion Paper*, 11 September 2009, page 17.

- (b) calculations are based on source data provided by the EDB / GPB. The source data used for prospective information is not required to be audited.<sup>193</sup>
- 6.22 We consider that audit requirements should be specific to the nature of the information being audited. For example, different audit requirements are appropriate for historical financial information to that for non-financial information due to the nature of the underlying information.
- 6.23 We have taken into account the standard of verification considered appropriate in each case when establishing audit requirements. Further, we understand that an auditor who qualifies as an Independent Auditor (as defined in the draft ID Determinations) would be qualified to complete all aspects of the audit engagement.
- 6.24 In the July 2009 discussion paper our preliminary view was that the auditing requirements for prospective financial and non-financial information should be similar to the standard of assurance required by the Securities Regulations 1983.<sup>194</sup> PricewaterhouseCoopers (PwC) considered that the scope of the auditor role must be consistent with the skill and expertise of external financial auditors.<sup>195</sup> PwC considered audits on AMPs, forecast information and pricing methodologies were not justified as they were outside traditional audit experience. Some submitters were concerned this level of assurance was excessive.<sup>196</sup> PwC submitted that the standard of assurance over prospective financial and non-financial information should be similar to the standard of assurance set out in the current EDB requirements.
- 6.25 The current EDB requirements specify that prospective financial and non-financial information be disclosed consistent with the regulatory accounting or technical measurement requirements used for disclosures for the current financial year and the immediately preceding financial year, calculated based on source data provided by the EDB.
- 6.26 We can monitor and analyse disclosures and identify issues with the information which is disclosed. This may be more cost-effective than imposing extensive audit requirements on prospective information including prospective non-financial information in AMP related disclosures which are not required to be audited.
- 6.27 We have adopted the audit standard specified in the current EDB requirements. We accept that the current requirements (supported by disclosed reconciliations of forecast to subsequent actual expenditure reconciliations) provide sufficient assurance of prospective financial and non-financial information, in historical financial and historical non-financial disclosures.

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<sup>193</sup> See Section 2.6 (Auditor's reports) of each of the draft ID Determinations.

<sup>194</sup> Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009, page 118.

<sup>195</sup> PwC, *Submission on Information Disclosure Discussion Paper*, 11 September 2009, page 27.

<sup>196</sup> For example, see: PwC, *Submission on Information Disclosure Discussion Paper*, 11 September 2009, page 23.

### *Form of audit reports*

- 6.28 The draft ID Determinations provide that:
- 6.28.1 the audit report contain a statement as to whether or not the disclosures comply with the requirements
  - 6.28.2 if the disclosures do not comply with the requirements, the audit report is to explain the respects in which the disclosure does not comply with the requirements.
- 6.29 We intend these provisions to be flexible enough to allow for changes in the New Zealand Auditing Standards and therefore avoid any conflicts which may arise should New Zealand Auditing Standards be amended.

### *Addressee/duty of care to the Commission*

- 6.30 The draft ID Determinations require that audit reports are addressed to directors, while containing a statement acknowledging a duty of care to the Commission.
- 6.31 The Commission initially proposed, in the July 2009 discussion paper, that audit reports be addressed to interested persons and contain a statement that acknowledges a duty of care to the Commission.<sup>197</sup> PwC was concerned that the proposal for audit opinions to be addressed to interested persons (and contain a duty of care to the Commission) would significantly increase the risk to auditors of taking on responsibilities to third parties with regard to their opinion.<sup>198</sup>
- 6.32 We have noted the concern and considered alternative options, including requiring the audit report to be addressed both to the directors and to the Commission. The proposed option avoids the Commission being a party to the audit engagement letter and recognises the interests of interested persons are represented by the Commission.
- 6.33 This approach is consistent with that proposed in our recently released consultation paper relating to a proposed amendment of the Specified Airport Services ID Determination.<sup>199</sup>

### *Auditor qualifications*

- 6.34 The draft ID Determinations provide that the auditor is required to:
- 6.34.1 be qualified as an auditor of a company under the Companies Act 1993, or where the regulated supplier is a public entity be the auditor-general
  - 6.34.2 have no relationship that involves, or is likely to involve, a conflict of interest

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<sup>197</sup> Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009, page 119

<sup>198</sup> PwC, *Submission on Information Disclosure Discussion Paper*, 11 September 2009, page 23.

<sup>199</sup> Commerce Commission, *Draft Commerce Act (Specified Airport Services Information Disclosure) Amendment 2010 – Consultation Paper*, 19 December 2011, at pp. 4-5.

- 6.34.3 not have assisted with the compilation of the information or provided advice or opinions on the methodologies or processes used in compiling the information
  - 6.34.4 not be associated with any person who has provided assistance, advice or opinions in preparing the disclosures.
- 6.35 We consider that the standards and guidance regarding auditor independence published by the Institute of Chartered Accountants (NZICA) also provides appropriate guidance relating to auditor independence.<sup>200</sup>

## 6.6 Publication and retention of information

6.36 This section discusses the publication and the retention of information.

### *Publication/form of disclosures*

- 6.37 The Commission may, under s 53B(1)(a), determine how information is to be publicly disclosed.
- 6.38 The draft ID Determinations provide that:
- 6.38.1 historical disclosures are to be publicly disclosed five months after the disclosure year end
  - 6.38.2 forecast disclosures are to be publicly disclosed prior to the first day of the forecast period
  - 6.38.3 where information must be disclosed in a standardised form, regulated suppliers must make disclosures using the standardised templates provided. Where standard templates are used, disclosures are to be made to us in Microsoft Excel format
  - 6.38.4 the pricing methodology, prices and AMP disclosures are to be publicly disclosed and price changes are to be notified to each consumer by whom the charge is payable
  - 6.38.5 the AMP document is to be provided as a Microsoft Word document capable of being searched by us
  - 6.38.6 information supporting disclosures is to be retained for at least seven years.
- 6.39 We have reconsidered the need for a notice to be published in the *Gazette*. Under the current requirements, notification in the *Gazette* is intended to advise that disclosures have been made. As most interested persons can readily access the disclosures on the relevant supplier's websites, and may not rely on the *Gazette* notice as due dates for disclosures to be made are pre-specified, we do not see any

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<sup>200</sup> New Zealand Institute of Chartered Accountants, *Code of Ethics: Independence in Assurance Engagements*, August 2003.

practical benefit from continuing to require notification in the *Gazette*. We propose to discontinue this requirement.

- 6.40 Our preliminary view, outlined in the July 2009 discussion paper, was that price disclosures should be notified to each consumer by whom a charge is payable.<sup>201</sup> Several submitters asserted that having prices publicly disclosed provides sufficient disclosure and that disclosure to each consumer by whom a line charge is payable is not needed.<sup>202</sup> Submitters noted that the customer relationship, in the case of EDBs, was with the retailer and customers were unaware which EDB provided their distribution services.
- 6.41 While we acknowledge the concerns we considered that *all* consumers should be informed when their line charges have changed. Accordingly the draft Determination requires that price disclosures be notified to each consumer by whom a charge is payable.

### **6.7 Disclosure period, initial disclosure year and transitional provisions**

- 6.42 This section addresses issues relating to the disclosure period, the initial disclosure year under the draft ID Determinations and the provisions to transition from the current requirements to the ID Determinations.

#### *GPB disclosure year*

- 6.43 The draft ID Determinations propose that the disclosure year for all GPBs is to be the year ended 30 September. This aligns with the proposed compliance period for price-quality regulation.
- 6.44 In our Initial Default Price-Quality Path for Gas Pipeline Businesses paper dated 1 April 2011,<sup>203</sup> on setting an initial DPP for GPBs, we proposed adopting the 30 September year-end as the basis for assessing compliance with the DPP. That paper also proposed aligning the compliance period with the pricing year. Our information disclosure process paper also proposed aligning ID periods with the assessment periods for default /customised price-quality paths.<sup>204</sup> Submissions received were varied in their support for the 30 September year-end. We note MDL<sup>205</sup> and Vector<sup>206</sup> expressed a preference that information disclosure reporting be aligned with their financial reporting periods of 31 December and 30 June respectively.

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<sup>201</sup> Commerce Commission, *Information Disclosure Discussion Paper*, 29 July 2009, page 114.

<sup>202</sup> For example GasNet *Submission on the Information Disclosure Discussion Paper*, 10 September 2009, page 31.

<sup>203</sup> Commerce Commission, *Initial Default Price-Quality Path for Gas Pipeline Businesses*, 1 April 2011, page 44.

<sup>204</sup> Powerco submitted that due to the interposed retailer relationship, requiring the EDB to notify consumers of new charges may confuse consumers (Commerce Commission, *Information Disclosure Regulation Electricity Lines Services and Gas Pipeline Services process and Issues Paper*, 23 February 2011, page 6.

<sup>205</sup> Maui, *Information Disclosure Regulation, Electricity Lines Services and Gas Pipeline Services: Submission to Commerce Commission on Process and Issues*, 9 March 2011, page 1.

<sup>206</sup> Vector, *Submission to Commerce Commission on Information Disclosure Process and Issues Paper*, 9 March 2011, page 6.

- 6.45 The preferences are acknowledged and have been considered. The advantages of having all suppliers disclosing information which covers the same period, and the period matching the proposed DPP assessment period, is considered to outweigh the preferences raised. Accordingly the draft ID Determinations provide for common disclosure year-end dates of 30 September for all GPBs.<sup>207</sup>

#### *EDB disclosure year*

- 6.46 The disclosure year for EDBs is the year ended 31 March. This is consistent with the current disclosure year under the current requirements.

#### *Timing of disclosures*

- 6.47 The transition from the current EDB Requirements and GPB Regulations is as depicted in Table 6.2 below:

**Table 6.2: Draft GPB/ EDB Determinations: when the requirements apply**

<b>Disclosure type</b>	<b>Disclosure year 2012*</b>	<b>Disclosure year 2013</b>	<b>Disclosure year 2014</b>
EDBs – Forecast disclosures	<i>Completed under current ID requirements (by 1 Apr 2011)</i>	<i>To be completed under current ID Determinations (by 1 Apr 2012)</i>	<i>To be completed under the new (currently draft) ID Determinations (by 1 Apr 2013)</i>
EDBs – Historic disclosures	<i>To be completed under the new (currently draft) ID Determinations (by 30 October 2012<sup>^</sup>)</i>	<i>To be completed under the new (currently draft) ID Determinations (by 31 August 2013)</i>	<i>To be completed under the new (currently draft) ID Determinations (by 31 August 2014)</i>
GPBs -forecast disclosures	<i>Subject to GIDRs (based on financial years)</i>	<i>To be completed under the new (currently draft) ID Determinations (by 1 Oct 2012)</i>	<i>To be completed under the new (currently draft) ID Determinations (by 1 Oct 2013)</i>
GPBs - Historic disclosures	<i>To be completed under the new (currently draft) ID Determinations (by 28 Feb 2013)</i>	<i>To be completed under the new (currently draft) ID Determinations (by 28 Feb 2014)</i>	<i>To be completed under the new (currently draft) ID Determinations (by 28 Feb 2015)</i>

\* Disclosure year 2012 means the year ending 31 March 2012 (EDBs) and 30 September 2012 (GPBs).

<sup>^</sup> A longer period in the initial year, reflecting in part that the ID Determination is expected to be finalised in May 2012.

<sup>207</sup> We are consulting on the draft gas DPP Determinations and Draft Reasons Paper, which is scheduled to be set by 29 February 2012. These draft ID Determinations have been set based on those draft Gas DPP documents.

## 6.8 Transitional provisions

- 6.48 We consider that a transitional financial information report is required, which shows the movements from previously disclosed regulatory asset values. This will assist interested persons to understand how the RAB for the initial disclosure year has been established.

### *Transition exemptions*

- 6.49 Changes to ID requirements may require the establishment of new systems, or changes to existing systems, to collect the information that is required to be disclosed. To give suppliers time to plan for, and then make, such changes, a number of exemptions are included in the Requirements. These are detailed in clause 2.10 of the draft ID Determinations. Key aspects of these transition exemptions as they relate to the provision of asset management information templates are discussed in Chapter 4.
- 6.50 As signalled previously, the disclosure year 2012 is proposed to be the first year when the new requirements apply.<sup>208</sup> Under the timetable for determining the ID Determinations, this will be finalised in May 2012, which is shortly after the completion of the EDB disclosure year 2012. This will reduce the time available to EDBs to complete the disclosures under the new ID Determinations. To offset this, we propose extending the due date for EDBs to disclose their historic 2012 information by October 2012.
- 6.51 We invite submissions on whether specific new or altered disclosure requirements should also be subject to individual exemptions or altered disclosure timeframes.

### *Continuity of information – for GPBs only*

- 6.52 The draft ID determinations propose that regulated suppliers disclose information in accordance with a common disclosure year-end – 31 March for EDBs and 30 September for GPBs.
- 6.53 Currently, under the GIDRs, GPBs disclose information in accordance with their financial year end. Most GPBs have a 30 June year-end with the exception of Maui Development Limited (MDL), which has a 31 December year-end. The change in disclosure year to September for all GPBs gives rise to a lack of continuity in the information disclosed by GPBs (either by 3 months, or in the case of MDL, 9 months).

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<sup>208</sup> Commerce Commission, *Information Disclosure Regulation Electricity Lines Services and Gas Pipeline Services Process and Issues Paper*, 23 February 2011, paragraph 19. At that time, the ID Determinations were intended to be finalised by December 2011. That timeframe was subsequently extended to allow additional time to develop the draft ID Determinations. See, Commerce Commission, *Information Disclosure Regulation Electricity Lines Services and Gas Pipeline Services Process Update*, 12 September 2011, paragraphs 13-15. The draft reasons paper for the GPB initial DPP contained a typographical error when it stated that “final information disclosure determinations will apply in respect of the 2012/2013 disclosure year” as that should have been a reference to the 2011/12 disclosure year (see, Commerce Commission, *Initial Default Price-Quality Paths for Gas Pipeline Businesses Draft Reasons Paper*, 21 November 2011, footnote 35).

- 6.54 To allow for continuity in the information disclosed, the draft ID determinations propose a number of part-year disclosure requirements. An example of this is in relation to the information that is rolled-forward (such as the RAB and Tax balances).<sup>209</sup>
- 6.55 Where information does not roll-forward from one year to the next (such as regulatory profit information and capital expenditure for example) the change in disclosure year can give rise to a gap in the information disclosed.
- 6.56 The options we have considered to address this gap include:
- 6.56.1 requiring full comparative (prior year) figures to be disclosed in the initial disclosures under the draft ID Determinations
  - 6.56.2 requiring certain information previously disclosed under the GIDRs to be provided for a 12 month transitional period prior to the initial disclosures required under the draft ID Determinations.
- 6.57 We consider that in relation to those GPBs with a 30 June balance date, where the gap in information is only 3 months, the lack of continuity in information is not material. We do not propose to require further information from these GPBs.
- 6.58 However, in relation to MDL where the gap is 9 months, we propose that MDL disclose the following information, in relation to the 12 month period to 31 December 2011:
- 6.58.1 Total revenue (a new requirement as MDL is exempt from disclosing revenue)
  - 6.58.2 Load factor
  - 6.58.3 System length
  - 6.58.4 Total customers.<sup>210</sup>
- 6.59 We consider that this level of disclosure is appropriate to cover the 9 month gap during which there would not otherwise be information available to interested persons.

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<sup>209</sup> Schedule 20 (GDBs and GTBs) and Schedule 21 (EDBs).

<sup>210</sup> The information proposed to be disclosed is outlined in clause 8, section 2.10 (Transition provisions) of the draft GTB ID Determination. This disclosure is only required five months after the end of Disclosure Year 2012.

## Attachment 1: Application of Historical Financial Information Requirements

### A1.1 Introduction

- A1.1 This annex explains how the historical financial information decisions, as outlined in Chapter 3 are to be applied and why.
- A1.2 The annex discusses:
- A1.2.1 the standard ROI calculation (section A1.2)
  - A1.2.2 the alternative ROI calculation (section A1.3)
  - A1.2.3 how related party transactions are to be valued and why (section A1.4)
  - A1.2.4 information about regulatory profit, including operating cost disclosures, depreciation, revaluations, regulatory tax allowance, term credit spread differential and pass through and recoverable costs (section A1.5)
  - A1.2.5 information about asset values, including RAB roll forward and works under construction (section A1.6).

### A1.2 Standard ROI calculation

- A1.3 As is discussed in Chapter 2, determining whether the purpose of Part 4 is being met requires some indicator of profits to be disclosed. The current EDB requirements require EDBs to disclose an annual return on investment (ROI) indicator. This value is expressed on an after-tax basis and is therefore intended to be comparable to the relevant post-tax WACC. By contrast, the current gas information disclosure regulations do not require GPBs to disclose any measure of returns.
- A1.4 This section sets out our proposal for the annual ROI indicator to be disclosed by both EDBs and GPBs. The indicator is disclosed on both a vanilla and post-tax basis to be comparable to a vanilla WACC and post-tax WACC respectively. The following section sets out an alternative ROI indicator that may also be disclosed by EDBs and GPBs should they consider the standard ROI would provide an inaccurate estimate of annual returns.

#### *Internal rate of return (IRR) calculations*

- A1.5 The most accurate assessment of the return of an investment is a cash-based internal rate of return (IRR) calculation over the lifetime of that investment. The IRR is the discount rate that, when applied to a future stream of net cash flows associated with an investment, equates the present value of those cash flows to the initial cost of the investment.<sup>211</sup>
- A1.6 Any returns indicator for a regulated supplier is likely to be just an approximation to the IRR. This is because indicators like an ROI often rely on accounting-based rather

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<sup>211</sup> For example, refer: OFT, *Assessing Profitability in Competition Policy Analysis*, Economic Discussion Paper 6, A Report Prepared for the Office of Fair Trading by OXERA, OFT657, London, UK, 2003, pp 32-34.

than cash-based data (eg, they use tax expense rather than tax paid, and/or use accruals), and are almost always assessed over a time period shorter than the economic lifetimes of the investments involved (eg, one year only).

- A1.7 If calculated over the entire lifetime of an investment, the IRR calculation does not rely on knowing the value of the assets associated with that investment at any time during the investment's lifetime. Only the cash inflows or outflows associated with the investment are required. Nevertheless, the value of the relevant assets employed can be readily determined in any year, as the asset value is simply the net present value of future cash flows associated with those assets from that year forward (discounted using the appropriate WACC).
- A1.8 IRR calculations can, however, be accurately undertaken over a shorter period than the lifetimes of the investments concerned, as long as the asset values at the beginning and end of that period are known and represent the discounted net cash flows from the relevant date forward. The asset value in any year during that period can also be readily determined, as the asset value will equal the net present value of future cash flows over the remainder of the period, plus the present value of the asset value at the end of the period (again, all discounted using the appropriate WACC). In practice, however, the asset value may only be able to reflect an *expectation* of future cash flows.<sup>212</sup>
- A1.9 Over a single year, the IRR can be found by solving for the IRR term in the following expression:

$$\begin{aligned} & \text{Asset Value at beginning of year} \\ & = \text{Sum of Discounted Net Cash Flows during year} \\ & \quad + \text{Discounted Asset Value at end of year} \end{aligned}$$

$$= \sum_i \frac{NCF_i}{(1 + IRR)^{p_i}} + \frac{AV_1}{1 + IRR}$$

where:

- $IRR$  = internal rate of return
- $NCF_i$  =  $i$ th net cash flows during the year
- $p_i$  = proportion of year elapsed  $i$ th net cash flow
- $AV_1$  = asset value at year-end.

A1.10 It is evident from the expression above that economic returns can arise from:

A1.10.1 the present value of net cash flows during the year, and/or

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<sup>212</sup> *Assessing Profitability in Competition Policy Analysis*, Economic Discussion Paper 6, A Report Prepared for the Office of Fair Trading by OXERA, OFT657, London, UK, 2003, p 42.

- A1.10.2 capital gains or losses associated with the economic asset value at the end of the year, which in turn represents the present value of subsequently expected net cash flows.

#### *Current ROI for EDBs*

- A1.11 The current ROI indicator for EDBs can be derived from the annual IRR expression above if it is assumed that:

- A1.11.1 net cash flows all occur at year-end, and are approximated by revenue, less capital additions (net of disposals), operating expenditure and tax
- A1.11.2 the asset value at year end is found from the RAB value at the beginning of the year, plus capital additions (net of disposals), less depreciation, plus revaluations
- A1.11.3 the IRR is replaced by the ROI.

- A1.12 In simplified terms, the current ROI for EDBs is therefore:

$$\frac{\text{Revenue} - \text{Depreciation} - \text{Opex} - \text{Tax}^{213} + \text{Revaluations}^{214}}{\text{RAB}(\text{beginning of year})^{215}}$$

- A1.13 Clearly revenue is actually received and costs are actually incurred throughout each year. Using an ROI indicator that recognises revenues and costs as occurring at the end of the year consistently and materially under-estimates supplier returns, due to the time value of money. Consequently, the current ROI indicator for EDBs is effectively NPV-positive in favour of suppliers.

- A1.14 As is discussed further below, our proposed new ROI indicator for EDBs and GPBs addresses this material under-estimation by using mid-year timing of revenue and

<sup>213</sup> The current ROI indicator includes the interest tax shield in the tax term, as it is intended to be comparable with a post-tax WACC (eg, Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraph G2.7).

<sup>214</sup> As noted above, the IRR recognises a capital gain/loss through higher/lower returns. The recognition of revaluations as income (or devaluations as an expense) in the current ROI indicator is a consequence of substituting the RAB roll-forward equation (Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraph 2.8.11) into the IRR calculation. In any event, a key pre-condition for any accounting-based measure of profit to be a reasonable approximation to the IRR is that, unlike GAAP, changes in asset value (including revaluation gains and losses) must be treated as income or as an expense (J. Edwards, J. Kay and C. Mayer, *The Economic Analysis of Accounting Profitability*, Clarendon Press, Oxford, 1987, pp 12-31, and refer Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraph 2.8.17).

<sup>215</sup> In practice, unlike revenue or other expense items, which are all assumed to occur at year end, the current ROI indicator for EDBs assumes that half the capital additions (net of disposals) occurs mid-year, and the remainder at the end of the year. This has been approximated in the current ROI by replacing the denominator with the RAB at the beginning of the year (ie the opening RAB), plus half the capital additions (net of disposals) during the year. This value was termed the 'regulatory investment value' of RIV. As is noted below, we are proposing to redefine the RIV term in the new ROI indicator for EDBs to have an opening and closing RIV value which is the sum of the RAB value and deferred tax.

expenditure items. Apart from addressing this issue, the proposed new ROI indicator also differs from the current one for EDBs as a result of applying relevant input methodologies.

*Effect of input methodologies on inter-year timing of income and cost items*

A1.15 The parameters in any new ROI indicator must apply the relevant input methodologies for information disclosure. A number of input methodologies applying to information disclosure for EDBs, GDBs and GTBs have an effect on when the timing of regulatory income or cost items is recognised between years.

A1.15.1 *Deferred tax approach* (for EDBs and GPBs only): the regulatory tax allowance is not based on tax payable amounts in the year they are actually incurred but is a notional tax expense approach. The cumulative difference between the annual regulatory tax allowance amounts and the annual tax payable amounts is reflected in a deferred tax adjustment to the RAB value.<sup>216</sup>

A1.15.2 *Capital contributions*: capital contributions are not recognised as income in the year they are actually received but are deducted from the RAB, which spreads the recognition of this income over the lifetime of the assets concerned.<sup>217</sup>

A1.15.3 *Value of commissioned assets*: capital expenditure is not rolled into the RAB until the assets are commissioned, at which point financing during construction is also included in the RAB value.<sup>218</sup>

A1.16 The application of these input methodologies creates significant inter-year differences in the amounts and timing of some regulatory income/cost items compared to their actual cash flow equivalents. However, these input methodologies are all intended to provide (close to) an NPV-equivalent outcome over time.

A1.17 Defining the new ROI indicator to be consistent with these input methodologies will also ensure that supplier returns are monitored under information disclosure regulation consistently with the way prices are set for the supplier where it is also subject to default/customised price-quality regulation. Nevertheless, default/customised price-quality regulation is intended to provide regulated suppliers with the opportunity to earn at least normal returns over an *entire* regulatory period, rather than in each and every year.

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<sup>216</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraphs 5.3.5-5.3.11. Under the input methodologies the RAB value is not itself adjusted—the deferred tax balance adjustment is made after the RAB is determined. For example, under the input methodologies for customised price-quality paths, building blocks allowable revenue is determined by including a return on the RAB value plus the deferred tax balance.

<sup>217</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraphs E7.1-E7.5.

<sup>218</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraph E5.1-E5.7.

A1.18 By being able to take a longer term view, our published summary and analysis of disclosed information under s 53B(2) will play an important role in placing any annual ROI indicator into context. We will be able to analyse the changes in disclosed annual ROIs over time, in light of changes in relevant disclosures relating to efficiency, to assist interested persons in assessing whether excessive profits are being limited, and whether financial capital is being maintained, consistent with the purpose of Part 4.<sup>219</sup>

#### *Intra-year timing of income and cost items*

A1.19 For those income and cost items in the ROI indicator that are not affected by *inter-year* timing, we considered whether it would be appropriate to assume that all amounts (with the exception of capital additions and disposals) are received at the end of the year. As noted above, this is the assumption in the current ROI indicator for EDBs. Our conclusion was that the use of a year-end time assumption would result in a material under-estimate of annual returns.

A1.20 A more accurate assumption would be that all revenues and expenditures are received or incurred *mid-year*, and our proposed ROI indicator for EDBs and GPBs (set out below) is based on this assumption.<sup>220</sup> We considered whether the ROI indicator could be made even more accurate, by being based on monthly amounts rather than by just assuming the full year amounts occur mid-year. However, given that monthly values might not always be readily available for all items, the possible additional compliance costs might not warrant any minor additional improvement in accuracy. In the case of EDBs, changing to a mid-year approach simply involves a change to the ROI calculation, rather than a change to the data used in the calculation, because it would still use the relevant revenue and expenditure amounts disclosed for the entire year.

A1.21 Nevertheless, if a supplier considers that the use of revenues and expenditure items disclosed on a monthly basis would result in a better estimation of returns than a mid-year timing assumption, it may do so as well. An alternative ROI which reflects the timing of those monthly amounts is discussed in the next section.

#### *End of year items*

A1.22 There are a number of income and cost items that have no cash equivalents, such as changes to the deferred tax balance (EDBs and GDBs only), depreciation and revaluations. All these items are determined by applying the relevant input methodologies and do not affect the asset value determined for regulatory purposes until the end of each disclosure year-ie they affect the opening RAB value and the

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<sup>219</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraphs 2.6.28 and 2.8.18. We could also calculate the ROI over an entire regulatory period, based on the asset values at the beginning and end of the period. It is important to note that a simple average of annual ROIs is only an approximation to an ROI calculation.

<sup>220</sup> The Commission has previously indicated that there would be merit in specifying an ROI performance measure in the form of an IRR calculation, with most income and cost items assumed to occur mid-year: Commerce Commission, *Regulation of Electricity Lines Businesses, Supporting Paper to the Exposure Draft of the Revised Information Disclosure Requirements, Specification of Return on Investment and Revised Draft methodology for Rolling Forward the Regulatory Asset Base*, 20 December 2007, pp 51-52.

opening deferred tax balance, where applicable, at the beginning of the next year. We refer to the total asset value for regulatory purposes—ie the combination of the opening RAB value and the opening deferred tax balance—as the ‘opening regulatory investment value’ (ie ‘opening RIV’).

A1.23 Each year, the opening RAB value is also affected by any lost and found assets identified during the previous year, and by any changes in the RAB due to changes in the application of the cost allocation input methodology. Given the calculated change in the RIV is effectively a decision determined by applying the relevant input methodologies, and that change occurs at the end of each year, none of those income and cost items should affect any intra-year amounts in the ROI indicator.

A1.24 Arguably, the interest margin used in calculating the term credit spread differential could be assumed as occurring mid-year. However, we do not consider the difference between mid-year and year-end recognition of the interest margin to be material. Therefore, we have treated the term credit spread differential in the ROI calculation as a year-end value.

#### *Proposed ROI for EDBs and GTBs*

A1.25 Using the IRR expression above as a starting point, our proposed annual ROI expression for EDBs and GTBs, comparable to a vanilla WACC, is as follows.<sup>221</sup>

$$RIV_o = \frac{\text{Revenue} - \text{Opex} - (\text{VCA} - \text{Adn}) - \text{Tax}}{(1 + ROI_V)^{0.5}} + \frac{(\text{RIV}_1 - \text{LFA} - \Delta\text{CA}) - \text{TCSD}}{(1 + ROI_V)}$$

where:

$ROI_V$  = ROI comparable to a vanilla WACC (‘vanilla ROI’)

$RIV_o$  = opening regulatory investment value =  $RAB_o + DTB_o$

$RIV_1$  = closing regulatory investment value =  $RAB_1 + DTB_1$

$RAB_o$  = opening RAB value

$RAB_1$  = closing RAB value--ie opening RAB for the following year

$DTB_o$  = opening deferred tax balance (nil for GTBs)

$DTB_1$  = closing deferred tax balance (nil for GTBs)--ie opening deferred tax balance for the following year

$Opex$  = operating expenditure during the year

<sup>221</sup> The ROI is determined by solving the formula for ROI. In practice, an excel IRR calculation allows for this. The formula can be presented in terms of the ROI by expressing it as a quadratic equation and by then applying the standard solution to a quadratic equation. However, doing so would add little value to the discussion.

- $VCA$  = value of assets commissioned during the year
- $Adn$  = value of asset disposals during the year
- $Tax$  = regulatory tax allowance for the year (which will be a tax expense amount for EDBs and GDBs, and a tax payable amount for GTBs)
- $LFA$  = net value of lost and found assets
- $\Delta CA$  = change in RAB over the year due to the application of cost allocation input methodology
- $TCSD$  = term credit spread differential.

A1.26 The equivalent ROI that is comparable to a post-tax WACC is found by subtracting the interest tax deduction (in percentage terms) from the vanilla ROI.<sup>222</sup>

$$ROI_{PT} = ROI_V - k_d T_c L$$

where:

- $k_d$  = cost of debt
- $T_c$  = corporate tax rate
- $L$  = leverage.

A1.27 The value of lost and found assets, and the change in RAB over the year due to the application of the cost allocation input methodology, are both deducted from the end-of-year RAB value. As a result, any increase in value due to found assets or to a change in cost allocation will not be recognised as income, and any decrease in value due to lost assets or to a change in cost allocation will not be recognised as an expense. It is appropriate that the ROI not be affected by lost and found assets because found assets are considered to have always been in existence and lost assets to have never existed. Therefore, no revaluation gain or loss should be reflected in the ROI.

A1.28 The case for excluding the effect of revaluation gains or losses due to cost allocation is less straightforward. For example, consider a case where the cost allocation input methodology requires that only half the value of an asset used in supplying both regulated and unregulated services is allocated to the RAB. Should the supply of unregulated services cease, the application of the cost allocation input methodology might result in the value of the asset in the RAB doubling.

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<sup>222</sup> The same result would be achieved by including the interest tax shield as an end-of-year deduction in the expression in paragraph A1.25 above (refer Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, paragraphs G2.7 and H2.7).

A1.29 It might appear to be inappropriate to ignore this revaluation of the RAB, particularly if that revaluation supports an increase in prices without any change in the level of service. However, given that the cost allocation input methodology limits any allocation of costs to the allocation that would arise using the avoidable cost allocation methodology, we consider that such an outcome is unlikely. Any costs (or asset values) that would be avoided as a result of the discontinuation of the supply of unregulated services, would not be recognised in the regulated part of the business.

### A1.3 Alternative ROI Calculation

A1.30 Where a supplier considers that the use of revenues and expenditure items disclosed on a monthly basis would result in a better estimation of returns than a mid-year timing assumption as required in the standard ROI calculation, it may disclose its monthly revenues and/or costs, and also disclose an alternative ROI indicator.

A1.31 Using the IRR expression above as a starting point, our proposed annual alternative ROI expression for EDBs and GPBs, comparable to a vanilla WACC, is as follows.

$$RIV_o + RWC_o = \sum_{i=1}^{12} \frac{Revenue_i - Opex_i - (VCA - Adn)_i - Tax_i}{(1 + ROI_V)^{\frac{i}{12}}} + \frac{(RIV_1 - LFA - \Delta CA) - TCSD + RWC_1}{(1 + ROI_V)}$$

where:

$RWC$  = revenue-related working capital (ie revenue from previous month).

A1.32 For simplicity, revenue, operating expenditure and capital expenditure monthly accruals are used to represent the regulated supplier's monthly cash flows. The total annual cash flows for tax are determined in accordance with the tax IM and the monthly recognition of the total tax allowance is aligned proportionately with the regulated suppliers' actual tax payments.

A1.33 Apart from the inclusion of revenue and expense items on a monthly basis, the other key difference in the alternative ROI expression is the inclusion of revenue-related working capital terms at the beginning and the end of the year. Cash receipts from revenues are assumed to be received at the end of the month they are accrued. In reality revenue is generally received on the 20<sup>th</sup> of the month following its accrual. A working capital balance representing the revenues from the previous month is included in the opening and closing investment to compensate for the fact that revenues are recognised a month earlier than actually received.

A1.34 There are a number of other known variances between assumptions and actual cash flows that have not been adjusted for because the cost of making the adjustment

would likely outweigh the potential benefits. Materiality, availability of data and complexity of the calculation are factors that have been considered when deciding not to adjust for known variances. Such unadjusted variances include:

- A1.34.1 Cash flows are assumed to have been received or paid at month end. This assumption variance is likely to understate disclosed returns.
  - A1.34.2 The adjustment for working capital only recognises revenue receipts and not payments that are deferred. This assumption variance is likely to immaterially understate disclosed returns.
  - A1.34.3 The deferred timing of electricity market wash ups are assumed to be recognised when they are accrued. The effect of the wash up on the disclosed returns will be under or over-stated depending on whether the wash up requires a payment or allows for further receipt of revenue.
  - A1.34.4 Revenue and costs are recognised as net of GST. In reality GST is collected from customers and paid to suppliers when revenue is received or costs are paid. Where the GST collected is greater than GST paid, which it is assumed to generally be, disclosed returns would be immaterially understated.
- A1.35 The expression for the alternative ROI indicator defines an ROI that is comparable to the vanilla WACC. The equivalent ROI comparable to a post-tax WACC is found in the same way as for the standard ROI (ie, paragraph A1.26 above).

#### **A1.4 Value of related party transactions**

- A1.36 To establish that a related party transaction is disclosed on an arms length basis, our draft ID Determinations propose some conditions around the disclosure of related party transactions. In particular, these conditions require the value of related party transactions to be based on, or linked to, objective verifiable information which helps demonstrate that the price approximates that which could be expected in an arm's length transaction.
- A1.37 In the next section we discuss related party transactions generally, before outlining our proposed approach with respect to opex (as reflected in the draft ID Determinations), and then capex (which is included in the asset valuation IM for each regulated service, and which we propose to amend in the manner described below).

#### *Background*

- A1.38 Parties which are related to each other may have different incentives when setting the terms and conditions of transactions than parties which are not related. The terms (especially price) and conditions agreed between the related parties, can influence the information disclosed by the regulated entity. For this reason, different considerations apply to the disclosure of related party transactions, than to other transaction values.

- A1.39 Where they are material, related party transactions can hinder interested persons' ability to assess whether the purpose of Part 4 is being achieved. For example, the presence of a material related party transaction may affect the assessment of:
- A1.39.1 incentives to invest and innovate
  - A1.39.2 efficiency (including the size of efficiency gains and whether they are being shared with consumers)
  - A1.39.3 whether a regulated supplier is limited in its ability to earn excessive profits (as monopoly profits could appear in the books of the related but unregulated party).
- A1.40 In their 2011 disclosures, EDBs reported related party transactions exceeding \$260m per annum under the current ID requirements. Of this total, the value of opex transactions exceeded \$90 million.
- A1.41 Approaches to determining the value of related party transactions differ between suppliers. Some use the cost incurred by the related party as the transaction value, others attempt to estimate a market price.
- A1.42 Many related party transactions involve the provision of electrical contracting services from a subsidiary company. The margins earned by electrical contracting businesses are disclosed in some suppliers' statutory financial reports. Our review of these documents identified significant differences in the margins being earned by such parties. For example, the pre-tax margin on sales earned by Horizon Energy on its contracting business averages 5.2% over 2010 and 2011,<sup>223</sup> while that earned by Marlborough Lines on its contracting business averages 10.6% over the same years,<sup>224</sup> although each contracting business primarily sells services to a related party (the regulated entity). What margin is included on the related party transactions solely with the regulated party (and disclosed under ID) is not stated.
- A1.43 When a regulated entity undertakes transactions with a related party, interested persons need to understand whether and how the information which has been disclosed may be affected by related party dealings. In particular, interested persons should have information which discloses:
- A1.43.1 the existence and extent of related party transactions;
  - A1.43.2 what the related party transactions relates to; and
  - A1.43.3 whether the price is the same or similar to the price which would be expected in an equivalent arm's length transaction (and if not, what adjustment is required to make it similar to an arm's length price); and

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<sup>223</sup> The average reported in its 2011 Annual Report for the financial year to March 2010 and March 2011. Horizon Energy Distribution Limited, *Annual Report 2011*, pp.45-46.

<sup>224</sup> The average reported in its 2011 Annual Report for the financial year to March 2010 and March 2011. Marlborough Lines Limited, *Annual Report 2011*, p.43.

A1.43.4 whether the price is based on objective, verifiable, information.

A1.44 Of these issues, establishing whether the price is equivalent to an arm's length price is the most difficult. There are two broad approaches.

A1.44.1 First, the supplier could demonstrate that the relationship between the parties has not affected the terms of the transaction (eg, price has been determined on a demonstrably arm's length basis).

A1.44.2 Second, if the price cannot be shown to reflect an arm's length price, sufficient information could be disclosed so the interested person knows the size of the impact from the parties' status as related parties, so the interested person can make an adjustment to offset this impact, thereby approximating a price which is representative of an arms' length transaction.

A1.45 Our view is that the current requirements relating to related party transactions do not provide sufficient, readily available information to allow interested persons to assess whether profits are consistent with those in a workably competitive market (or what adjustments are required to make them consistent). In particular, the current requirements do not require the disclosure of objective information which demonstrates that related party transactions are consistent with those in a workably competitive market (or what adjustments are required to approximate the value of transactions in a workably competitive market).

A1.46 Given the significant disclosed value of related party transactions, we have considered how the disclosure regime can provide sufficient information to interested persons to assess the value of related party transactions.

### *Options*

A1.47 In the background materials for the financial issues workshop, we identified six different options for the treatment of related party transactions. The six options were:

A1.47.1 Retention of the status quo

A1.47.2 Transactions to be disclosed using arm's length prices

A1.47.3 Transactions to be included at cost to the related party providing the service

A1.47.4 Require additional disclosure of prices in excess of an arm's length price

A1.47.5 Require more information (including margins on external sales)

A1.47.6 Require transactions to be disclosed at cost unless the supplier also makes significant external sales on the same basis as for related party transactions (the Ofgem approach<sup>225</sup>).<sup>226</sup>

A1.48 Suppliers who attended the Financial Issues Workshop indicated that they established prices on an arm's-length market price basis (option b above). However, there was little information to identify market prices, and many suppliers were unable to objectively identify how it could be demonstrated that the transaction was equivalent to an arm's length price. The lack of objective information was attributed to a small number of potential providers, and a lack of comparable transactions.

A1.49 Suppliers at the workshop noted the difficulty of establishing market prices using tenders including, for example, in some regions of the country when the number of potential suppliers was small. Further, for good business reasons, many regulated businesses preferred that related parties supply important services.<sup>227</sup> As a result, there was no or little objective information that supported the proposition that the related party price represented prices consistent with a workably competitive market.

#### *Related party transactions – treatment of opex*

A1.50 Our draft ID Determinations propose that a regulated supplier must disclose the value of related party transactions on at least one of the following bases:

A1.50.1 At the cost incurred by the related party providing the service

A1.50.2 At the direct cost incurred by the related party providing the service plus a mark-up on direct costs which does not exceed 17.2%, where the transaction involves the provision of electrical contracting services<sup>228</sup>

A1.50.3 At the transaction value, where the related party makes at least 75% of its sales to unrelated parties and the prices charged to the regulated supplier are demonstrably the same as those charged to unrelated parties

A1.50.4 At the transaction value, where the services in question had previously been outsourced and the regulated supplier can demonstrate that the cost

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<sup>225</sup> Ofgem does not generally permit the inclusion of any internal profit margins of the licensee or related party margins in the regulatory asset value unless the related party concerned earns at least 75 per cent of its turnover from sources other than related parties and charges to the licensed entity are consistent with charges to external customers.

<sup>226</sup> Commerce Commission, *Workshop 3: Financial Disclosure Requirements – Specific Issues and Draft Templates*, 10 June 2011, paragraph 8-9.

<sup>227</sup> For example, a number of suppliers stated that they preferred to use related parties, as the related party took a longer term view of the relationship and were more willing to invest in training and the assets used to provide the contracted services, than outsourced providers. On the other hand, Orion's disclosures explain that its transactions with related parties take place on an arms-length basis, established on the basis of contestable tenders.

<sup>228</sup> The benchmark margin has been set based on analysis of the margins earned by a range of firms engaged in electrical contracting. This analysis is set out at paragraphs A1.58-A1.66.

of supply from the related party was the same or less than the costs incurred under the previous outsourced arrangement

A1.50.5 At the transaction value, where the value of all transactions with that related party is less than 1% of the regulated supplier's total revenue from the regulated service for that year and the total value of all related party transactions is less than 5% of the regulated supplier's total revenue from the regulated service

A1.50.6 At the transaction value, where:

- (a) open competitive tenders have been used, and
- (b) the directors can certify that the tender was open, that it was run to ensure there were credible competing tenders, and the lowest qualifying tender was selected

6.59.2 In all other cases, the transaction should be disclosed at a nil value.

A1.51 The purpose of these provisions is to assure interested persons, including ourselves, that the value disclosed for services received from a related party is consistent with a workably competitive market and can be shown to be based on objective information. One important practical implication of this approach is that a supplier cannot disclose a value for the transaction based solely on the existence of an agreement between related parties.

A1.52 The first two options include reliance on the costs incurred by the related party. To provide interested persons with some assurance that these costs are reasonable, the draft ID Determinations require that Directors of the regulated entity certify that, having undertaken reasonable enquiries, they are satisfied that the costs are fair and reasonable to the regulated entity for the work undertaken.

A1.53 The requirement for the price to be based on objective and verifiable information improves our ability to test the values placed on related party transaction, including through spot audits where necessary.

A1.54 The draft ID Determinations propose that the default position, if no other option is elected from the list provided in paragraph A1.50, is for the related party transaction to be stated at nil value. This is intended to incentivise a supplier which has undertaken related party transactions with a material value, to take any steps necessary to adopt one of the other options.

#### *Related party transactions – treatment of capex*

A1.55 The Asset Valuation IM requires that the value of a commissioned asset which was acquired from a related party is to be "... its depreciated historic cost in respect of

the related party ... or ... where sufficient records do not exist to establish this cost, its market value as at its commissioning date as determined by a valuer”<sup>229</sup>.

A1.56 Unison has requested a change to this IM to permit market valuations on asset transfers from related parties, irrespective of whether historic cost information exists.<sup>230</sup> In our interim response to Unison, we indicated that we agreed an amendment to the IM may be warranted and proposed this be consulted on formally, including with other interested persons.<sup>231</sup>

A1.57 We consider that a similar approach to that outlined above at paragraph A1.50 could be adopted for assets acquired from a related party. Such an approach would ensure that a consistent approach, relying on objective information, is taken for all related party transactions whether they relate to operating or capital expenditure. Amendments to the respective IMs applicable to EDBs and GPBs would be required.<sup>232</sup> Subject to submitters views on the proposed approach outlined above at paragraph A1.50, we propose to consult on a range of potential amendments to the IMs (as discussed in Attachment 3).

#### *Typical Margins Earned by Electrical Contracting Businesses*

A1.58 The various options for determining the value of a related party transaction includes an option allowing a mark-up on direct cost of no greater than 17.2%. In the following paragraphs we explain how this percentage was estimated.

A1.59 We identified a range of listed electrical contracting businesses (refer Table 12.1) and estimated their average margin using information reported by Bloomberg. A range of possible approaches to establishing the value to be recorded by a regulated party for related party transactions exist. One possible approach is for the regulated party to record related party transactions at a value which reflects cost of provision to the related party plus a margin which does not exceed the margin earned by companies comparable to the related party. This approach requires the identification of potential comparable companies to the related party and the margins earned by these potential comparable companies.

#### *Process used to identify electrical contracting businesses*

A1.60 Electrical contracting businesses, listed in New Zealand, Australia, the UK and the US, were initially screened using the following Bloomberg classifications:

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<sup>229</sup> Commerce Commission, *Commerce Act (Electricity Distribution Services Input Methodologies) Determination 2010*, Paragraph 2.2.11(g). Commerce Commission, *Commerce Act (Gas Distribution Services Input Methodologies) Determination 2010*, Paragraph 2.2.11(g). Commerce Commission, *Commerce Act (Transpower Input Methodologies) Determination 2010*, Paragraph 2.2.7(h). Commerce Commission, *Commerce Act (Specified Airport Services Input Methodologies) Determination 2010*, Paragraph 3.9(e).

<sup>230</sup> Unison, *Letter to Karen Murray Re: Treatment of transactions between related parties*, 24 January 2011.

<sup>231</sup> Commerce Commission, *Letter to Unison Re: Treatment of transactions between related parties*, 25 February 2011.

<sup>232</sup> At some future point in time, we may consider whether to extend these changes to Specified Airport Services and Transpower also.

- A1.60.1 Building – Heavy Construction
- A1.60.2 Building & Construction – Miscellaneous
- A1.60.3 Commercial Services
- A1.60.4 Diversified Operations
- A1.60.5 Electric - Integrated
- A1.60.6 Electric Products – Miscellaneous
- A1.60.7 Engineering / R&D Services.

A1.61 This resulted in a very large pool of entities, which was then reviewed to identify those individual entities which mainly provided services substantially the same as electrical contracting businesses.

A1.62 This process identified twelve electrical contracting businesses (one from Australia, one from the UK and ten from the US). These companies are set out in Table 12.1 below.<sup>233</sup>

A1.63 For each of the electrical contracting businesses, we identified the margins on sales over time. This too is summarised in Table 12.1.<sup>234</sup>

**Table 12.1: Typical margins earned by electrical contracting businesses**

Name	Country	Gross Profit / Sales Margin	EBITDA / Sales Margin	EBIT / Sales Margin	Net Profit before Tax / Sales Margin	Total Assets (\$m local currency)
Southern Cross	Aust	33.2%	14.6%	13.2%	12.8%	87
T Clarke	UK	13.2%	4.7%	4.1%	4.4%	77
Dycom	US	20.3%	10.0%	4.9%	3.2%	725
Emcor	US	11.0%	2.7%	2.1%	1.3%	2756
Goldfield	US	12.7%	5.8%	-1.3%	-1.2%	21
Integrated Electrical	US	15.9%	3.2%	1.9%	-0.3%	205
KBR	US	4.6%	3.4%	2.9%	3.0%	5417
Mastec	US	18.9%	8.7%	5.4%	2.1%	1656
MYR	US	12.5%	6.8%	4.7%	3.6%	380

<sup>233</sup> As a cross check, various ad hoc historical electrical contractor industry surveys were located and examined to determine whether there were any other listed entities which might be potential comparable companies. For example, we cross-checked our list against the UK Top 50 Companies: *Electrical Times, The Top 50 Electrical Contractor Report, 2011*.

<sup>234</sup> The margins for each company have been obtained from the annual financial statements data recorded by Bloomberg. The respective values shown for each company in Table 1 are the average of the margins from all of the annual financial statements data recorded by Bloomberg. The annual financial statements data recorded by Bloomberg extends back up to 20 years.

Name	Country	Gross Profit / Sales Margin	EBITDA / Sales Margin	EBIT / Sales Margin	Net Profit before Tax / Sales Margin	Total Assets (\$m local currency)
Pike Electric	US	15.1%	13.7%	7.6%	4.3%	493
Primoris	US	12.2%	7.4%	5.8%	6.3%	704
Quanta	US	17.2%	10.3%	6.8%	4.4%	4341
SUMMARY						
Average		15.7%	7.3%	4.2%	2.9%	
Median		14.7%	6.3%	4.3%	4.0%	
25 <sup>th</sup> %		11.4%	3.1%	1.6%	0.4%	
75 <sup>th</sup> %		19.2%	11.1%	6.9%	6.4%	

A1.64 As the margin considered moves from being based on Gross Profit / Sales to being based on Net Profit before Tax / Sales, the likelihood increases that accounting adjustments not directly related to the continuing, operational electrical contracting business affect the observed margins. Therefore, the Gross Profit / Sales margin is considered to be the best basis for determining the margin earned by companies comparable to electrical contracting businesses.

A1.65 There is no obvious link between company size (as determined by total assets) and the average margins earned.

A1.66 The median Gross Profit / Sales margin earned by companies comparable to electrical contracting businesses is 14.7%. This equates to a mark-up of 17.2% on direct costs.<sup>235</sup>

### A1.5 Regulatory profit disclosures

A1.67 This section outlines the information about regulatory profit that is required to be disclosed to allow interested persons to assess whether the purpose of Part 4 is being met. The disclosure of information supporting cost allocation, depreciation, revaluations, term credit spread differential and regulatory tax allowance are discussed.<sup>236</sup>

#### *Cost allocation disclosures*

A1.68 The draft ID Determinations require public disclosure of information to allow interested persons to understand how the cost allocation methodology has been applied, and non-public disclosure of information to us for the purposes of

<sup>235</sup> I.e.,  $14.7\% / (1 - 14.7\%) = 17.2\%$ .

<sup>236</sup> Other elements of regulatory profit were discussed above, specifically the disclosure of information about related party transactions (paragraphs A1.50-A1.57) and operational expenditure category disclosures (paragraph 4.50-4.51).

monitoring compliance.<sup>237</sup> This section discusses the cost allocation information required to be publicly disclosed.

- A1.69 The IM Reasons Paper outlines how costs and asset values are to be allocated between regulated and unregulated activities.<sup>238</sup> The allocation of costs can have a significant impact on the reported performance of a regulated supplier. Accordingly, an understanding of the degree to which common costs have been allocated and where that allocation has changed is required for interested persons to assess a regulated supplier's performance.
- A1.70 For interested persons to understand how costs have been allocated, regulated suppliers must disclose information about the cost and asset allocator used within each operating cost or asset category. This includes the value of:
- A1.70.1 costs directly attributable to electricity distribution services for each operating cost or asset category
  - A1.70.2 not directly attributable costs/asset value for each operating or asset category, including the value of any arms length deduction and the values allocated to electricity distribution services and non-electricity distribution services
  - A1.70.3 any OVABAA<sup>239</sup> allocation increase.
- A1.71 This information is also supported by qualitative disclosures about the methodologies applied in each operating cost or asset category, including:
- A1.71.1 the methodologies applied
  - A1.71.2 a description of the assets to which each methodology applies
  - A1.71.3 where ABAA<sup>240</sup> or OVABAA methodologies are used, whether the allocators are proxy asset allocators, proxy cost allocators or causal allocators
  - A1.71.4 the allocators used and the rationale for using each allocator.
- A1.72 Regulated suppliers were required to apply the cost allocation input methodology and disclose information on a similar basis to the draft proposal as part of the starting price adjustment 53ZD notices. Analysis of those disclosures identifies limited application of the arms length deduction and OVABAA mechanisms. Although these mechanisms may not be applicable for regulated suppliers at present, these mechanisms were required for the purpose of s. 52T(3) of the Act. The draft ID

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<sup>237</sup> Paragraphs 3.61-3.70 discussed the disclosure of information for the purpose of monitoring compliance.

<sup>238</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, chapter 3.

<sup>239</sup> Optional variation to the accounting based allocation approach.

<sup>240</sup> Accounting based allocation approach

Determination is also required to provide for application of these mechanisms in the instance that they are used in the future.

- A1.73 The draft ID Determinations also require that when cost or asset allocation methodologies or cost or asset value allocator metrics change, additional disclosure of operating cost line items and assets must be made in the year of change. This must include the disclosure of allocation values in the year of change as well as the year before and after so that interested persons can understand the effect of the change. Regulated suppliers must also include the reasons for the change.
- A1.74 This approach is appropriate as a time series of data is required to fully understand the impact of the change in methodology or metric and this should incentivise regulated suppliers not to change the methodologies and metrics unless the change is material and will outweigh the additional cost of reflecting these in disclosures.

### *Depreciation*

- A1.75 The draft ID Determinations require the disclosure of information on how assets are being depreciated. Depreciation is a significant component of regulatory profit. Given the IM determinations cater for the use of asset lives that are not standard, interested persons require information on depreciation to assess profits.
- A1.76 Standard asset lives are outlined in Schedule A of the IM determinations and are required to be applied using straight line depreciation in accordance with clause 2.2.5 of those determinations. The application of standard asset lives and a standard methodology provides uniformity in the determination of depreciation. Clause 2.2.8 of the IM determinations also provides for the use of asset lives that are not standard. The use of asset lives that are not standard is limited to where standard asset lives have not been determined for the asset or where, in limited circumstances, it is appropriate to use a life other than the standard asset life.
- A1.77 To provide interested persons with an understanding of how depreciation is determined, regulated suppliers are required to disclose for each asset that is not depreciated using a standard asset life or an alternative depreciation methodology:
- A1.77.1 a description of the assets
  - A1.77.2 the reason standard depreciation is not being applied
  - A1.77.3 the year the change was made
  - A1.77.4 depreciation charge for the period
  - A1.77.5 closing RAB under 'non-standard' depreciation
  - A1.77.6 closing RAB under 'standard' depreciation.

### *Revaluations*

A1.78 The draft ID Determinations includes a disclosure outlining the revaluations calculation. Revaluations are a significant component in regulatory profit and the disclosure of the calculation allows interested persons to understand its drivers.

### *Pass through and recoverable costs*

A1.79 The value of pass through and recoverable costs are required to be disclosed. To assess efficiency interested persons need an understanding of costs that are outside the control of management.

A1.80 Pass through and recoverable costs are a component of price-quality regulation. Pass through and recoverable costs are considered to be outside the control of management and are therefore excluded from price-quality path regulation. Although they have not been excluded from the ROI calculation we consider it appropriate that they be separately disclosed so that interested persons can exclude them if deemed appropriate. It is also appropriate to exclude them from efficiency assessments and therefore they are not disclosed as part of operational expenditure.

### *Term credit spread differential*

A1.81 A firm with a longer term debt may pay a credit premium over what it would if the term of the debt premium had matched the term of the risk-free rate. The additional cost of the higher interest is known as the term credit spread differential.

A1.82 The draft ID Determinations allow a regulated supplier to recognise an allowance for the long term credit spread differential, if the regulated supplier's debt portfolio has a weighted average original tenor greater than five years.

A1.83 Schedule 4 of the draft ID Determinations require the disclosure of information where an EDB or GPB meets the criteria for recognising the allowance. The disclosure provides interested persons with an understanding of why an EDB or GPB has been provided the allowance.

### *Regulatory tax allowance*

A1.84 The draft ID Determinations require that regulated suppliers prepare and disclose a reconciliation of regulatory profit to the regulatory tax allowance, which is calculated in accordance with the treatment of tax provisions of the IM Determinations.<sup>241</sup>

A1.85 Regulatory tax is a significant component of regulatory profit. Accordingly, for interested persons to assess movements in profitability over time, information regarding the movement in the tax allowance is required. In determining tax expense it is standard practice for businesses to take accounting profits and adjust them to determine taxable income for which the tax expense is derived. Regulated

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<sup>241</sup> See part 2, subpart 3 of each of the IMs Determinations. *Commerce Act Electricity Distribution Services Input Methodologies Determination*, 23 December 2010; *Commerce Act Gas Distribution Services Input Methodologies Determination*, 23 December 2010; *Commerce Act Gas Transmission Services Input Methodologies Determination*, 23 December 2010.

suppliers, therefore, will have information that reconciles the regulatory income to taxable income.

A1.86 Interested persons are therefore able to understand the movements in the regulatory tax allowance by understanding the regulatory profit and what adjustments have been made to it to determine the regulatory tax allowance.

A1.87 The IM Reasons Paper outlines our methodology and reasons for disclosing information regarding the regulatory tax allowance in greater detail.<sup>242</sup>

### **A1.6 Asset value information disclosures**

A1.88 This section outlines the information about asset values that is required to be disclosed to allow interested persons to assess whether the purpose of Part 4 is being met.

A1.89 This section discusses the disclosure of the RAB roll forward in general and works under construction.<sup>243</sup>

#### *RAB roll forward*

A1.90 The draft ID determinations require the disclosure of the RAB roll-forward for a period of 5 years. The unallocated value of the assets in the RAB is also disclosed for the current disclosure year.<sup>244</sup>

A1.91 The RAB roll forward is calculated in accordance with the asset valuation provisions of the IM determination.<sup>245</sup> As outlined in the IM Reasons Paper the value of the RAB in any given year is determined by rolling forward the unallocated value of the assets in the RAB from previous years and allocating the relevant values to the RAB.<sup>246</sup> The RAB roll-forward includes an adjusting item which accounts for changes over time in the proportion of shared assets which is used for providing specified services.<sup>247</sup>

A1.92 The RAB is a key component in the assessment on profits and other regulatory objectives in the Part 4 Purpose. Hence, it is important that interested persons have sufficient information to allow them to understand how the RAB was rolled forward

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<sup>242</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 22 December 2010, Chapter 5.

<sup>243</sup> This paper has already discussed some topics relative to this section. See the previous section (Section 8.5) on the disclosure of information about asset allocations, depreciation and revaluations and paragraphs 4.50-4.55 (discusses the disclosure of capital expenditure by category and class).

<sup>244</sup> The unallocated value of the assets in the RAB uses the same list of assets as the RAB (which is allocated) but unlike the later includes the proportion of the value of the asset which is allocated to non-regulated services.

<sup>245</sup> See part 2, subpart 2 of each of the IM Determinations. *Commerce Act Electricity Distribution Services Input Methodologies Determination*, 23 December 2010; *Commerce Act Gas Distribution Services Input Methodologies Determination*, 23 December 2010; *Commerce Act Gas Transmission Services Input Methodologies Determination*, 23 December 2010.

<sup>246</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 23 December 2010, chapter 4.

<sup>247</sup> Line entry 'adjustment resulting from cost allocation' on Schedules 4 and 23 of the ID Determination.

(e.g. the ability to reconcile opening and closing values) and to have confidence in how the asset valuation IM and cost allocation IM were applied. This will require regulated suppliers to disclose the results of the key steps in the calculation including each of the key movements in the unallocated RAB which result from the application of the asset valuation IM (eg, revaluation of the unallocated opening RAB).

*Works under construction*

- A1.93 The draft ID Determinations require regulated suppliers to disclose details on the roll forward of works under construction. This disclosure must show the value of capital expenditure and assets commissioned in accordance with the relevant asset valuation IM.<sup>248</sup>
- A1.94 GAAP requires the disclosure of works under construction which is the value of assets being constructed or assets which have been constructed but not yet commissioned. Changes in the value of works under construction, therefore, arise from capital expenditure and assets commissioned. The disclosure of these allows interested persons to reconcile their assessment of capital expenditure with the roll-forward of the RAB, effectively linking efficiency assessments with profits and other assessments that use the RAB value.
- A1.95 To ensure comparability to the forecasts of key capital projects and the RAB, both of which are allocated, as well as to the unallocated value of the assets in the RAB disclosed in the RAB roll-forward, the draft ID Determination requires that both unallocated and allocated values are disclosed for works under construction. For reasons of simplicity and consistency, this allocation must be calculated in a manner consistent with either the principles of the Cost Allocation IM or the assumptions used in formulating the key capital expenditure forecasts.

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<sup>248</sup> Addressed in part 3 of the IMs Determinations. See part 2, subpart 2 of each of the IM Determinations. *Commerce Act Electricity Distribution Services Input Methodologies Determination*, 23 December 2010; *Commerce Act Gas Distribution Services Input Methodologies Determination*, 23 December 2010; *Commerce Act Gas Transmission Services Input Methodologies Determination*, 23 December 2010.

## Attachment 2: EA Pricing Principles for EDBs

A2.1 The pricing principles published by the Electricity Commission / Electricity Authority for EDBs are as follows<sup>249</sup>

- (a) Prices are to signal the economic costs of service provision, by:
  - (i) being subsidy free (equal to or greater than incremental costs, and less than or equal to standalone costs), except where subsidies arise from compliance with legislation and/or other regulation;
  - (ii) having regard, to the extent practicable, to the level of available service capacity; and
  - (iii) signalling, to the extent practicable, the impact of additional usage on future investment costs.
- (b) Where prices based on 'efficient' incremental costs would under-recover allowed revenues, the shortfall should be made up by setting prices in a manner that has regard to consumers' demand responsiveness, to the extent practicable.
- (c) Provided that prices satisfy (a) above, prices should be responsive to the requirements and circumstances of stakeholders in order to:
  - (i) discourage uneconomic bypass;
  - (ii) allow for negotiation to better reflect the economic value of services and enable stakeholders to make price/quality trade-offs or non-standard arrangements for services; and
  - (iii) where network economics warrant, and to the extent practicable, encourage investment in transmission and distribution alternatives (e.g. distributed generation or demand response) and technology innovation
- (d) Development of prices should be transparent, promote price stability and certainty for stakeholders, and changes to prices should have regard to the impact on stakeholders.
- (e) Development of prices should have regard to the impact of transaction costs on retailers, consumers and other stakeholders and should be economically equivalent across retailers.

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<sup>249</sup> Electricity Commission, *Distribution Pricing Principles and Information Disclosure Guidelines*, February 2010, pp. D-E.

### Attachment 3: Proposed Amendments to IMs

A3.1 In the IMs reasons paper, the Commission noted that there may be reason to amend the EDB / GPB IMs to align them with any new developments that arose in the implementation of the IM:

The determination of IMs for EDBs and GPBs marks a significant milestone in the implementation of the new Part 4 regime. This implementation will continue throughout 2011 and 2012 with the consultation on starting price adjustments for the current DPP for EDBs under s 54K(3), as well as setting of:

- information disclosure requirements for EDBs and GPBs that are consistent with Part 4 and the relevant IMs
- the first DPP for GPBs.

As a result of this ongoing consultation and implementation, the Commission anticipates that some relatively minor consequential amendments to the IMs may be required to align the IMs with the regulatory instruments. Examples are discussed throughout this Paper and include:

- the approach to determining quality standards for GPBs under CPPs
- the categories of expenditure that EDBs and GPBs must use in submitting a CPP proposal, which the Commission considers should align with information disclosure.

Such amendments should improve the effectiveness of the overall regulatory regime. The Commission will consult on any amendments in accordance with ss 52V and 52X.<sup>250</sup>

A3.2 After considering submissions from interested parties on this Paper and the draft ID Determinations, we will issue a paper outlining any material amendments to the IMs that may be necessary for the final ID Determinations to align with the IMs. We will invite submissions on any proposed material amendments to the IMs at that time.

A3.3 Table A3.1 below summarises the key areas where amendments to the IMs are likely to be considered.

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<sup>250</sup> Commerce Commission, *Input Methodologies (Electricity Distribution and Gas Pipeline Services) Reasons Paper*, 23 December 2010, paragraphs 1.2.21-1.2.23.

**Table A3.1: Proposed amendments to IMs**

<b>Nature of the amendment / reasons</b>	<b>Affected Determinations</b>	<b>Relevant IM Clauses</b>
<p><b>Asset management information – alignment of opex and capex categories</b></p> <p>See discussion in paragraphs 4.50-4.54 of this Paper</p>	<p>Decisions 710,711,712</p>	<p>Schedule D, specifically the Interpretation clause in D1.</p>
<p><b>Prescribing approach to related party transactions</b></p> <p>The treatment for related party transactions for assets is prescribed in IMs, it is not prescribed for opex. The draft ID Determination proposes approaches for disclosing related party opex transactions which will result in that being different to that for assets in the IMs. We think it makes sense to align the approaches for opex and capex to match the approach set out in this paper. Corresponding changes to the IMs for CPPs could be made to ensure a consistent treatment of related party transactions across ID and CPPs.</p>	<p>Decisions 710,711,712</p>	<p>Amend IM clauses:</p> <p>EDB - clause 2.2.11(g) and 5.3.11(g)</p> <p>GDB - clause 2.2.11(g) and 5.3.11(g)</p> <p>GTB - clause 2.2.11(g) and 5.3.11(g)</p>
<p><b>Setting a specific gas disclosure year – amend the regulatory disclosure period to 12 months ending 30 Sep instead of the current 30 Jun or 31 Dec</b></p> <p>Some of the IMs are set on the basis of a different year end (based on individual suppliers’ financial year end) so there is a 3 month period adjustment to align with the proposed new disclosure year.</p>	<p>Decisions 711,712</p>	<p>For GDBs and GTBs, amend definition of ‘disclosure year’ in clause 1.1.4(2) of the IM, and the IMs for asset valuation and tax to allow values (including the initial values for 2010) to be calculated consistent with the start and end dates of a disclosure year on a 30 Sep basis. Clauses 2.2.1-2.2.3 in the IM determinations.</p>