

15 August 2008

Information Disclosure Review
Network Performance Branch
Commerce Commission
P O Box 2351
Wellington

By email: electricity@comcom.govt.nz

SUBMISSION ON REVISED ELECTRICITY DISCLOSURE REQUIREMENTS

- 1 Orion welcomes the opportunity to submit on the Commerce Commission's (the **Commission**) *revised electricity information disclosure requirements* consultation document (**the Proposal**).
- 2 We have been a party to and fully endorse the Electricity Network Association's (**ENA**) submission on the Proposal.
- 3 We are also aware of Pricewaterhouse Coopers' (**PwC**) detailed review of the Proposal's information reports and definitions. We endorse many of PwC's comments. Later in this submission, we note any points of difference we have with PwC's submission and also expand on matters discussed by PwC.
- 4 Our submission is in two parts:
 - 4.1 general comments; and
 - 4.2 specific comments on the proposed disclosures, definitions and the handbook.

GENERAL COMMENTS

Process issues

- 5 We wish to again raise our concerns and indicate our growing frustration with the Commission's processes in relation to information disclosure,

including the ad hoc use of Section 98 notices to require and obtain additional information disclosure.

- 6 In our earlier submission¹ relating to the draft information disclosure requirements released in December 2007, we raised our concerns about responding to that consultation paper:
 - 6.1 without a clear understanding of the regulatory regime within which the information disclosed ultimately would be employed;
 - 6.2 with uncertainty surrounding the ongoing status of the thresholds regime; and
 - 6.3 without a clear understanding of future valuation methodologies and their use.
- 7 None of the above issues have been resolved, which means we are still extremely limited as to the extent to which we can provide meaningful commentary on the relative merits of the Commission's latest proposed revisions to the disclosure regime.
- 8 We are also concerned that our continued response to the Commission's proposals under these circumstances may give a false impression that we endorse the Commission's ongoing process. We submit that the Commission's current information disclosure review process should halt until the direction of the future regulatory regime is defined with clarity.

Process timelines and resource constraints

- 9 The Commerce Amendment Bill (**the Bill**) has been returned to the House by the Commerce Select Committee. By midway through September it will be clear whether Parliament will enact the Bill in the current parliamentary year or defer it until a later time.
- 10 If the Bill is not enacted this year, the Commission has indicated it will proceed with the 2009 reset process. As shown by the timelines below, there is significant incoherency between the Commission's work-streams. For example, new information requirements will be released in September 2008 yet final decisions on the threshold reset methodology are not due until December 2008.

¹ Orion New Zealand Limited submission on the draft Electricity Information Disclosure Amendment Requirements issued 20 December 2007, 7 March 2008.

Threshold reset 2009 current process timetable

Indicative dates	Milestone
Completed Dec 2007	Publication of and consultation on the discussion paper
Completed Jun 2008	Publication of the methodology paper update
Sep 2008	Publication and consultation on the initial decision paper
Oct 2008	Conference and cross-submissions on the initial decisions paper
Nov 2008	Indicative threshold levels published (to include a short consultation)
Dec 2008	Publication of final decision paper
Feb 2009	Publication of and consultation on draft Gazette Notice
1 Apr 2009	New thresholds to apply following publication of Gazette Notice

Information disclosure current process timetable

Indicative dates	Milestone
25 Jul 2008	Commission released explanatory paper and revised exposure draft
15 Aug 2008	Submissions on revised exposure draft and explanatory paper due
Sep 2008	Release new requirements
28 Feb 2009	Disclosure of financial statements and performance measures in accordance with new requirements for the year ended 31 March 2008
1 Apr 2009	Disclosure of 2009-19 asset management plan

- 11 We are concerned that the proposed September 2008 release of the information disclosure requirements pre-empts the outcome of consultation on the 2009 reset. It is extremely unclear whether information disclosure requirements set in advance of the outcomes of the 2009 reset consultation round would provide appropriate information disclosure.
- 12 We consider that it is far more logical to defer any further work on the information disclosure regime until it is clear whether or not the Bill will become legislation in this parliamentary year.
- 13 We note that if the Bill is enacted in this parliamentary year then the Commission must implement information disclosure requirements as soon as practicable after 1 April 2009. The Select Committee report on the Bill clearly identifies the purpose of information disclosure regulations.² Clause 53A of the Bill states:

The purpose of information disclosure regulation is to ensure that sufficient information is readily available to interested persons to assess whether the purpose of this Part is being met.

It is unclear to us whether the Proposal's information disclosure requirements will meet this purpose. If the Proposal doesn't satisfy the above purpose, then the Commission and EDBs will need to undertake further changes in the near future should the Bill be enacted.

- 14 As mentioned above, the Commission has indicated that if the Bill is not enacted in this parliamentary year, it will proceed with the 2009 reset process. We consider that in this circumstance the Commission will need to re-evaluate whether time constraints preclude proceeding with the 2009 reset while observing the necessary sound processes.
- 15 In either case, we consider that to continue to develop information disclosure requirements in the absence of a clear future regulatory direction is an unnecessary impost on scarce EDB resources.
- 16 The Commission also appears to have overlooked the significant logistical problems that EDBs would face over the period between September and January in:
- 16.1 responding to the 2009 threshold reset consultation;

² Commerce Amendment Bill (201-2) (28 July 2008) as reported by the Commerce Select Committee. See: Clause 53A, p27.

- 16.2 implementing pricing necessarily based on the outcomes of the 2009 threshold reset;
- 16.3 normal annual budgeting; and
- 16.4 simultaneously implementing systems to capture or create data to meet the proposed new information disclosure requirements.

Requirements to provide information that we do not already collect

- 17 We have already raised our concerns³ about the Commission's proposed requirements to provide data that we currently do not collect, such as valuation disclosures by prescribed asset class and price and quality splits on a connection point class/customer class basis.
- 18 In relation to requiring pricing information split on a connection point class/customer class basis, contrary to the views expressed by industry experts at the June 2008 workshop, the Commission's Proposal requires that data be provided by customer class – this split is based on a draft distribution pricing methodology paper (being prepared under the auspices of the Electricity Commission), as follows:⁴

The Commission understands that the draft Distribution Pricing Methodology (being prepared under the auspices of the Electricity Commission) has adopted customer classes that include break-points at 15kVA and 70 kVA. Since these are the basis on which pricing methodologies are to be disclosed, the Commission considers it logical to require disclosure of average network price levels on the same basis. As voltage supply levels are not part of the industry definition being developed for pricing methodology disclosure, the Commission has therefore removed this aspect of its draft definition.

- 19 We consider that the requirements in the Proposal to disclose average network price levels on the basis of the Commission's understanding of the draft distribution pricing methodology pre-empt the outcome of consultation yet to be carried out by the Electricity Commission on this issue.
- 20 We also recommend that the Commission follow the advice of industry experts at the Commission's workshop, who recommended against the inclusion of requirements to disclose data on a customer class basis.

³ See our comments at the Commission's workshop, our letter to Michael Clark dated 5 August 2008 and our response to the recent Section 98 notice.

⁴ Paragraph 140 of the Proposal.

21 We also wish to emphasise that one of the fundamental reasons that Orion adopted a wholesale pricing regime was to improve efficiencies through reducing the costs of:

21.1 data collection;

21.2 data processing; and

21.3 data maintenance.

The Proposal would negate those efficiency gains and effectively increase costs, further stifling incentives on EDBs to innovate.

22 The Electricity Commission or the Commerce Commission will be required to develop pricing methodologies or model approaches (plural)⁵ for distribution pricing. We consider that any pricing methodologies developed must provide EDBs with the opportunity to innovate – for example with pricing options which provide forward-looking price signals to optimise future levels of investment in their networks.

23 We have developed and continue to develop innovative pricing structures. We consider it would be extremely detrimental for customers if regulatory standardisation was to restrict our development in this area.

24 We recommend that if the Commission continues with the Proposal to require pricing information disclosure, then it should only be required at the class level on which the individual EDB bases its prices.

Previous response to the Commission

25 We have already submitted on the draft disclosure requirements released in December 2007⁶ and participated in the subsequent workshop. In that submission we broadly agreed with several aspects of the proposals, namely:

25.1 that the choice of disclosure and valuation methodologies should be guided by economic principles. As we have emphasised on past occasions, we believe that the purpose of economic regulation

⁵ Clause 52S of the Commerce Amendment Bill (201-2) (28 July 2008) as reported by the Commerce Select Committee, and paragraphs 110 – 112 of the May 2008 Government Policy Statement on Electricity Governance require the Electricity Commission to develop pricing principles or model approaches to distribution pricing.

⁶ Orion New Zealand Limited submission on the draft Electricity Information Disclosure Amendment Requirements issued 20 December 2007, 7 March 2008.

should be to replicate to the greatest extent possible the outcome of competitive markets in circumstances where the prospect of competition is limited;

- 25.2 that indexation by CPI should occur in the periods between formal ODV valuations;
 - 25.3 movement away from strict compliance with GAAP compliant financial statements to a set of prescribed disclosures which are based on, but may depart from, GAAP; and
 - 25.4 treatment of capital contributions and vested assets as income in the year of receipt.
- 26 However, we also raised a number of general areas of concern, namely:
- 26.1 that deferred tax should be removed from regulatory information disclosures;
 - 26.2 that there is insufficient clarity regarding the ongoing regulatory framework to contemplate a departure from ODV as the base for regulatory disclosure purposes at this time. We have submitted regularly over the years in support of ODV as our preferred valuation methodology, since it models the notional averagely-efficient new entrant in a competitive market. We submitted in support of ODV in our submission dated 17 November 2005 on the Commerce Commission's *valuation of the regulatory asset base decision paper* that:
 - (a) the existing ODV Handbook is significantly out of date and markedly understates our actual replacement costs, and accordingly an ODV based on the current handbook is significantly understated;
 - (b) we have concerns with the impracticality or impossibility of preparing disclosures retrospectively to the 1 April 2004 starting point. We also have concerns regarding the excessive level of detail required – for example, the extent of the disclosures required within reports MP1 and AV1; and
 - (c) a better starting point for this revised disclosure regime is that all EDBs undertake a new ODV, based on an updated ODV Handbook, as at either 31 March 2008 or 31 March 2009, and that the revised information disclosure requirements apply from the start of the 2008/09 year – i.e. from 1 April 2008 – at the earliest.

- 27 Given the passage of time since our previous submission, and the lack of certainty as to the future regulatory framework, clearly a commencement date for the revised information disclosure of 1 April 2008 as indicated above in paragraph 26.2(c) is no longer viable.
- 28 Although some of our issues of concern identified in paragraph 26 above have been addressed by the transitional provisions outlined in Part 4 of the Proposal, we are still concerned that some of the required apportionments and disclosures are arbitrary and would result in EDBs collecting data for no other purpose than that it is required by the Commission. As indicated above, this would add unnecessary costs.

Proposal needs worked examples

- 29 Many areas of the Proposal would be easier to understand if comprehensive worked examples were provided. Consequently, we submit that if the Proposal (suitably modified) is adopted, it must be accompanied by substantial supporting documentation including worked examples. We also recommend that the Commission hold further workshops to provided additional guidance.

Reduction of information disclosure information

- 30 We do not consider that there is any further need for the Commission to collect data to support comparative benchmarking on efficiency. This view appears to be shared by the members of the Commerce Select Committee, which recommended in its recent report on the Bill that the Commission should be precluded from undertaking comparative benchmarking on efficiency in determining the default price-quality path.⁷ In the event that the 2009 reset does in fact progress, and this threshold becomes a deemed default price-quality path, it would be illogical for the Commission to include a component in this threshold which is inconsistent with the proposed Section 53P(7A).

⁷ Commerce Amendment Bill (201-2) (28 July 2008) as reported by the Commerce Select Committee. See: Clause 53P(7A), p39.

SPECIFIC COMMENTS ON THE PROPOSED DISCLOSURES, DEFINITIONS AND HANDBOOK

- 31 The rest of our submission deals with more detailed aspects of the Proposal, however we reiterate that the Proposal should not proceed at present.
- 32 We again emphasise our position that providing further comment on the detail does not indicate our support for the ongoing proposal.
- 33 We note that PwC has extensively reviewed the proposed information disclosure reports, definitions and handbook for several EDBs. In general, we endorse and support PwC's submission. In the following paragraphs we note any points of difference we have with PwC's submission and also expand on matters discussed by PwC.

Report FS1

- 34 We have previously submitted that vested assets and cash capital contributions should be recognised as revenue in the year of vesting, rather than spread as income over the life of the asset – regardless of the accounting treatment under NZ GAAP. Further, we submit that the appropriate basis for valuing vested assets should be an estimate of their current replacement cost, not the ODV Handbook's outdated replacement cost as stated in the Proposal (paragraphs 85-86).
- 35 We noted in our earlier submission that there may be other differences between accounting and regulatory treatments, and so the categorisation required would be extremely difficult to derive. This is particularly the case where refurbishment and renewal expenditure may be being treated somewhat differently for accounting purposes than the ODV model suggests; e.g. a major reconductoring expenditure may be capitalised for accounting purposes, but not result in an increase in ODV as the underlying pole age has not been changed. The expenditure categories are not clearly defined and consequently there will be differences amongst the categorisation used by different EDBs. Further, one item of expenditure may easily fall into two or more categories. We submit that the number of categories should be minimised unless significant benefits from analysing the data further can be demonstrated.
- 36 There is also a lack of guidance about what is sought in the FS1c report. For routine and preventative maintenance, for example, is the 15% materiality to be applied to individual projects (if any meet the threshold), or to asset categories (if any meet the threshold) or to labour and materials (which we would not be able to provide as we receive all-inclusive contract

prices from our contractors)? Does the Commission expect that these 15% categories will all have some disclosure?

Report FS2

- 37 We primarily analyse our assets by their 'type' – lines, transformers, switchgear, cables, etc.
- 38 The purchase of an item of equipment (e.g. a transformer or piece of switchgear) is often undertaken without a clear linkage to one of the "primary purposes" identified in FS2. A new transformer might initially be used to replace one which has become overloaded, but could subsequently be used in a new subdivision or replace one which has failed. We move transformers and certain types of switchgear within our network throughout their lives. We also note that the proposed apportionment is arbitrary, as some jobs have elements of more than one category and we would need to analyse each job at completion to determine the primary 'purpose' or to apportion the purpose across two or more categories.
- 39 It appears to us that the FS2 report now requires the disclosure of asset-related capital expenditure, as opposed to works actually commissioned. This is an improvement over the December proposal which sought assets commissioned within each of the primary purpose categories. However, as noted in our March submission, it is not straightforward for us to apportion assets in the categories proposed.
- 40 Overall, without adequate justification by the Commission of how this extra information will be used, we can see no compelling argument to retain this in the Proposal.
- 41 If NZ IFRS requires EDBs to capitalise interest costs during construction, will interest costs be included in the assets added in this report? This creates an issue in subsequent revaluations as the ODV Handbook does not allow for interest during construction.
- 42 We also note that the approach taken in the determining the regulatory investment value, which becomes the denominator of the proposed ROI, excludes the annual depreciation expense, which we believe should be deducted. Further, in a year in which a revaluation takes place, the proposed formula excludes the revaluation from the denominator. We contend that a much simpler approach – (opening plus closing regulatory asset base) divided by two – provides a much more logical and defensible denominator.

Report FS3

- 43 We are concerned that the Commission has failed to consult fully with respect to regulatory tax. A number of issues have not been addressed. Tax was specifically excluded from the industry workshops held in late 2005. For regulatory purposes a notional reporting EDB entity is being created, and so we contend that a notional tax calculation should be used which disregards asset ownership structures and interest issues. We have previously submitted that the appropriate base for tax depreciation should be the regulatory depreciation, as regulatory depreciation should mirror the depreciation charge of relevance to an averagely-efficient new entrant – assuming that handbook (regulatory) replacement costs are reasonable.
- 44 Any other approach treats an EDB differently on the basis of whether it has held the regulated assets for a long period of time, or recently acquired those assets. All other things being equal, an EDB which has held the assets for a long period will have lower tax depreciation, and therefore higher tax expense, and therefore a lower net profit and return, than an EDB who recently acquired the assets for a multiple of regulatory ODV. Conversely, an EDB which recently acquired the assets for a multiple of their regulatory ODV will have a large tax depreciation expense, and therefore lower tax expense, and therefore a higher surplus on the same assets.
- 45 If we wish to compare one ‘notional’ EDB with another, then calculating tax on a consistent basis is important – the ownership history of the assets should not have an impact. This would be distortionary, and the notional tax calculation should correct for this by replacing tax depreciation with the ‘regulatory’ depreciation.
- 46 No guidance has been given with respect to deferred tax. We have previously submitted that deferred tax gains or losses are unlikely ever to crystallise as tax paid, and consequently that deferred tax should be ignored from the derivation of the regulatory tax allowance.
- 47 We have also stated previously that the interest tax shield should be removed from the calculation, as EBIT is used in calculating income tax, and deductible interest should be removed from the report as well. Instead, in the Proposal the FS3b report now introduces a notional deductible interest which results in the reported regulatory tax allowance disclosed in report FS1 becoming artificially lower, and the reported regulatory profit/loss (pre-financing and distributions) becoming artificially higher, than they would be for a company which has little debt. Also, the disclosed tax reported regulatory profit/loss (pre-financing and distributions) is actually no longer truly pre-financing as the result includes an interest tax shield benefit. This issue is discussed further in paragraph 60 below.

Report AV1

- 48 The indexation of asset additions, opening ODV and accumulated depreciation is unduly complex. Firstly, does the Proposal envisage the opening net ODV split into replacement cost and accumulated depreciation, or just for the net ODV to be entered into row 10? Secondly, we believe the report could be simplified by indexing the net assets carried forward from the previous year, rather than by indexing gross additions and depreciation. The requirement to reconcile this report back to the 2004 ODV would be very difficult, and as noted earlier in this submission (refer 26.2(c)) a preferable approach is to undertake a new ODV at 31 March 2008 or 2009, and then use this as the basis to roll the valuation forward between regular on-going ODVs.
- 49 We also note that AV1a should make an allowance for a reduction in accumulated depreciation for assets removed or written off during the year.

Report AV2

- 50 It is not possible for us to provide a breakdown of asset value by asset class unless each individual asset is actually assigned to an asset class of the Commission's choosing. Firstly, to comply we would require a very detailed schedule of how ODV categories are to be converted to the mandated category. Secondly, as time goes by it will become extremely onerous, maybe impossible, to track each of the prescribed line items in rows 13-18 of the report – essentially segregating out the assets included at opening ODV and then tracking those assets forward over a multi-year period. We struggle to see any benefit from doing so. At a maximum, we could possibly disclose the net total in the various classes, but the report as designed is unworkable in a multi-year period.

Report AV3

- 51 We agree with Part IV of PwC's submission that the rework and repetition of data between reports AV1, AV2 and AV3 is extremely inefficient and inconsistent, and will require us to start another record keeping regime, with tax; NZ IFRS (revaluation); NZ IFRS (cost) and now regulatory values, and for the regulatory assets to be tagged in a number of different ways – eg, primary purpose and asset class. Further, we seek to clarify whether capital expenditure includes donated and/or subsidised assets, and whether the comparator intends to measure commissioned works or actual capital expenditure.

- 52 We are extremely concerned that data is being requested on the basis that it might be nice to have, rather than because it is needed for monitoring or control purposes. This further supports our view that an ongoing ODV regime is preferable to an IHC-based methodology, started from a baseline ODV.

Report MP1

- 53 We agree with PwC's submission on the detail required by report MP1.
- 54 We note in addition to PwC's comments in relation to "Overhead circuit length by terrain (at year end)" that EDBs already publicly disclose these splits in their ODV reports. We consider it unnecessary to duplicate this information or to update the information annually. There is unlikely to be any material movement in relative proportions on an annual basis or during the intervening period between ODV derivations.
- 55 We note in addition to PwC's comments in relation to "Transformer capacity (at year end)" that there is little justification for Zone Substation Transformer Capacity. This is not a measure that is suitable for comparisons between EDBs because distributors have many different network configurations. Some have multiple levels of zone transformers and others have minimal use of them.
- 56 Further to PwC's comments on "System Fixed Assets Age (at year end)" we note that the indicator $(1-(DRC/RC))$ is distorted as a result of the values of land and spares, which don't age and also the minimum remaining life of three years used in the ODV method. We don't consider that this small distortion (less than 10%) will be material for Orion.
- 57 We agree with PwC that there is no explanation of the use of non-coincident demand.
- 58 While we agree that electricity volumes and loss ratios are important, the Commission's proposed loss ratio calculation includes unaccounted-for energy (from metering data errors, theft, etc), which is an issue that is managed by retailers not EDBs. Hence, it cannot be considered a measure of an EDB's performance. EDBs cannot be held accountable for this part of the energy 'losses'. We therefore recommend that a note be added in the schedule to clarify that the losses calculated include both technical and non-technical losses.

Report MP2

- 59 Further to our comments on loss ratios in paragraph 58 above, the loss calculation (in MP1) will result in all-up losses. This is not a measure of network performance. It is not possible to measure network-only losses in this manner. Given this position, we cannot disclose a technical loss factor or provide the Commission with an appropriate alternative measure to monitor an EDB's performance. However, we have explained our approach to managing technical losses in our AMP, which we believe to be appropriate and responsible. We recommend that the Commission should use this as the basis for EDBs to disclose their method of managing technical losses.
- 60 As noted in our previous submission, we are also concerned about a number of components of the ROI calculation, including:
- 60.1 the numerator should not be adjusted for the impact of an interest tax shield as the regulatory profit in report FS1 should be prepared on an EBIAT basis. In the current Proposal, an interest tax shield is artificially created in report FS3b, artificially reducing tax expense due to the notional interest deduction, only to have the interest tax shield undo the impact of the adjustment. We believe that the correct basis for the ROI calculation should properly be on an EBIT basis, with EBIT also being the starting point for deriving the regulatory tax allowance; and
 - 60.2 the approach taken in the denominator of the proposed ROI excludes the annual depreciation expense, which we believe should be deducted. Further, in a year in which a revaluation takes place, the proposed formula excludes the revaluation from the denominator. We contend that a much simpler approach – (opening plus closing regulatory asset base) divided by two – provides a much more logical and defensible denominator.

Report MP3

- 61 We agree with PwC's submission on report MP3.
- 62 We operate a charging basis which uses grid exit metering information. It is not possible for us to provide the information proposed by customer class from our own records.
- 63 We consider that a number of the Commission's comments in relation to EDBs obtaining metering information and profile information outlined in paragraphs 142 to 145 of the Proposal are, in our opinion, incorrect.

- 64 We wish to emphasise that one of the fundamental reasons that Orion adopted a wholesale pricing regime was to reduce data collection, data processing and data maintenance costs to improve efficiencies. The Proposal will reduce these efficiency gains and effectively increase costs.
- 65 We note that we do not charge our major customers on a volume basis (kWh) at all – our charges to them are based solely around their demand, and we consider it would be meaningless to attempt to convert this in some way to a volume basis.
- 66 This matter was also addressed in the June 2008 workshop, where industry experts recommended against the inclusion of the measure, or if there were to be customer classes then these could be:
- 66.1 largest five customers;
 - 66.2 largest customers (>300kVA); and
 - 66.3 mass market.

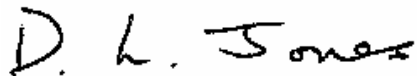
Report AM1

- 67 It is unclear whether the intention of AM1 is to report only actual “cash” expenditure; whether it is intended to include the value of vested assets; or whether it is intended to include only the works actually commissioned during the year.
- 68 As noted above in our comments regarding report FS2, the arbitrary nature of the required split of additions is a concern. Regardless of whether commissioned works or cash capital expenditure is required, we will have to start tracking additional data on each project to enable us to provide the information for report AM1.

Concluding remarks

- 69 Thank you for the opportunity to make this submission. Orion does not consider that any part of this submission is confidential. If you have any questions arising from this submission, please contact Dennis Jones (Industry Developments Manager), DDI 03 363 9526, email dennis.jones@oriongroup.co.nz.

Yours sincerely

A handwritten signature in black ink that reads "D. L. Jones". The signature is written in a cursive style with a large initial 'D' and a long horizontal stroke for the 'L'.

Dennis Jones
Industry Developments Manager