
Submission to the Commerce Commission

on

Proposed amendments to the
information disclosure determination for
electricity distribution services

Made on behalf of 18 Electricity Distribution Businesses

*PwC submission on
behalf of a group of 18
electricity distributors*

July 2017

Introduction

Overview

1. This paper forms our submission on the Commerce Commission's (Commission) consultation on proposed amendments to information disclosures (ID). These proposals are set out in the following documents released on 30 June 2017:
 - Draft Companion Paper, "Proposed amendments to information disclosure determinations for airport services, electricity distribution services, and gas pipeline services" (the Companion Paper)
 - "[DRAFT] Electricity Distribution Information Disclosure Amendments Determination 2017" (the Draft EDB Amendments)
 - Draft amendments for gas pipeline services and airport services.
2. This submission only considers the proposed amendments to ID for electricity distribution services.
3. This submission has been prepared by PricewaterhouseCoopers (PwC) on behalf of the following 18 Electricity Distribution Businesses (EDBs):
 - Alpine Energy Limited
 - Aurora Energy Limited
 - EA Networks
 - Eastland Network Limited
 - Electricity Invercargill Limited
 - Electra Limited
 - Mainpower Limited
 - Marlborough Lines Limited
 - Nelson Electricity Limited
 - Network Tasman Limited
 - Network Waitaki Limited
 - Northpower Limited
 - OtagoNet Joint Venture
 - The Lines Company Limited
 - The Power Company Limited
 - Top Energy Limited
 - Waipa Networks Limited
 - Westpower Limited.
4. Together these businesses supply 26% of electricity consumers, maintain 44% of total distribution network length and service 68% of the total network supply area in New Zealand. They include both consumer owned and non-consumer owned businesses, and urban and rural networks located in both the North and South Islands.
5. We trust this submission provides useful input to your consultation on the proposed ID amendments. We would be happy to answer any questions you may have regarding this submission.
6. The primary contact for this submission is:

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Summary

Amendments proposed

7. The EDBs who support this submission:
 - a) broadly support the proposed amendments to the cost allocation and cost of capital ID requirements, and have included some suggested drafting refinements. We note that some formulae in the spreadsheet schedules will need to change, and these spreadsheets have not yet been released for review
 - b) wish to clarify the timing of the cost allocation and cost of capital amendments, as they appear to be proposed to apply from one year earlier than when then corresponding IM clauses are to apply from
 - c) support in principle the proposed change of asset health classification, but note that the proposed classification system does not cover all ID asset classes and wish to understand how those assets would be treated
 - d) do not support the proposed new requirement to provide RAB value information by asset class. It is not possible for EDBs to provide this information, since regulatory asset valuation registers were not developed using the ID asset classes which were only introduced in 2012. In addition, this proposal would, if implemented, suggest a direct link between the physical assets of EDBs and their RABs. However the asset valuation IM results in deviations between the actual physical assets in use and value. Accordingly attempting to align physical asset attributes and RAB values is likely to be misleading and hence of limited value to interested parties
 - e) do not support the proposal to replace cross references to specific clauses in the IMs with cross references to the IM subpart, as this increases complexity for users of the ID.
8. For the avoidance of doubt we do not support any attempt to pro rate asset values by asset class. We do not consider this would be meaningful, and it would add unreasonable cost and complexity to annual disclosures. We also do not consider that it is necessary to develop another set of asset categories for asset valuation information, given the disjoint between physical assets and RAB, as noted in this submission.

Amendments not considered

9. We acknowledge the significant effort which the Commission has invested in developing the IDs, assessing compliance with them, developing and publishing ID databases and, more recently, developing and publishing targeted summary and analysis reports. However there is now a substantial backlog of ID issues which have not been addressed, as set out in the Companion Paper, and there is a risk that ID is not adequately fulfilling its purpose.
10. We therefore encourage the Commission to accelerate the ID amendment work streams to address the back log of issues which have built up. This will ensure the IDs are better able to meet their statutory purpose by providing high quality and relevant information for stakeholders. It will also remove compliance issues and therefore reduce compliance costs for the Commission and regulated suppliers. We also suggest it is timely, and good regulatory practice, to consider whether there are opportunities to remove, refine or supplement the information to be disclosed.
11. In this respect we encourage the Commission to publish a programme of future ID work streams incorporating planned summary and analysis work, and ID amendments. This could include scope and timing for ID amendments and summaries, and how these are to be prioritised.

Amendments proposed

Cost allocations

12. The 2016 Input Methodology (IM) Review introduced a requirement that any allocations of costs and assets to regulated activities, made using either the accounting based allocation approach (ABAA) or optional variation accounting based allocated approach (OVABAA), could not exceed in aggregate the amount which would be allocated under the ACAM method (IM 2.1.1(4)). It also removed the ACAM option for the allocation of not directly attributable costs and assets and required more support for the use of proxy allocators (IM 2.1.3).
13. Accordingly there are two key proposed changes to cost allocation disclosures, both of which reflect the changes to the cost allocation IM:
 - a) The removal of the requirement to specify whether costs or assets have been allocated in aggregate using ACAM, and the introduction of a requirement to summarise the instances in which ACAM has been used to limit the amount of costs or assets allocated to regulated activities.
 - b) The addition of a requirement to, in each case where a proxy allocator is used, explain why a causal relationship could not be established, and explain the rationale for the quantifiable measure used for the proxy allocator.
14. The Draft EDB Amendments also include a number of minor drafting changes, which appear to be intended to make the requirements clearer.

Determination drafting

15. We support the proposed changes to the ID which are consistent with the IMs, however we suggest the following changes to the proposed ID determination drafting to address ambiguity and potential errors.

Clause	Proposal	Suggested alternative	Explanation
2.3.5	...for each expenditure category ... and each asset category ... that is not directly attributable-	... for each expenditure category ... and each asset category ... that includes not directly attributable items-	An expenditure or asset category is not necessarily wholly 'directly attributable' or 'not directly attributable'.
2.3.5(5)(a)	-whether the allocators used are proxy asset allocators or proxy cost allocators	-whether the allocators used are proxy asset allocators, proxy cost allocators or causal allocators	It is possible for causal allocators to be used, and hence this option should be retained in this clause.

Clarification of date of first application

16. Clause 1.1.2(4) of the EDB IMs specifies that these amendments will apply from 1 April 2018. We note that paragraphs 4.4 and 4.10 of the Companion Paper suggest that an earlier application may be required. For example the references 'for the 2018 year-end disclosure onwards' and 'from the commencement of disclosure year 2019' in paragraph 4.10 appear to be contradictory. As the IMs state, the amendments are intended to apply from the commencement of the disclosure year 2019.

17. We suggest the Commission clarify this point, as it was consulted on during the IM review, and the decision reflects the outcomes of that consultation. We note that similar ambiguity is introduced elsewhere in the Companion Paper for example when indicating when the proposed amendments to the cost of capital disclosures will apply.

Cost of capital

18. The proposed changes to cost of capital information reflect the 2016 IM review amendments, in particular changes to some of the fixed parameters used in the estimation of the regulatory cost of capital for EDBs, and amendments to the term credit spread differential (TCSD) term.
19. It is proposed that the following changes are made to EDB ID determination:
 - a) Adjust the leverage figure in Schedules 2 and 5c to 42%
 - b) Adjust the term credit spread differential calculation in Schedule 5c to reflect the revised IM formula, and remove the associated definitions no longer required
 - c) Adjust the ID definition of the 'cost of debt assumption' and associated definitions to reflect the revised IM formula.
20. The Draft EDB Amendments also include a number of minor drafting changes, which appear to be intended to make the requirements clearer.
21. We support the proposed changes to the ID. We consider that they appropriately implement the changes to the cost of capital IM.

Spreadsheet templates

22. We note that some of the spreadsheet formulae in Schedule 5c will need to change, in addition to changes in labelling and table fields in order to implement the changes to the TSCD ID requirements. As revised spreadsheet templates have not yet been issued, we have not been able to review the appropriate formulae.

Asset health grading

23. It is proposed that the current grading system for EDB asset health information is replaced with a grading system which aligns to the Electricity Engineers' Association's (EEA) asset health indicator scale. It is intended that this will avoid potential grading errors which may result when translating gradings from one system to another. It is also intended to improve alignment of disclosure data with industry standards.
24. In general, we support changes to regulatory requirements which better align them with actual business processes, as this makes disclosures easier to prepare and more relevant for users of the information.
25. However, there appear to be some practical difficulties with using the EEA asset health indicator guidance in the way envisaged. In particular, we understand that the EEA classification does not cover all of the asset classes included in ID Schedule 12a. The following extract from the 2016 Guide¹ explains:

The methodology and grading criteria presented in this guide are not intended to be prescriptive, nor are they intended to represent a standardised approach for benchmarking or comparison between organisations. In applying the guide, users should consider the context of the business and balance the cost and effort associated with collecting and

¹ Electricity Engineers Association, Asset Health Indicator (AHI) Guide 2016, pages 2-3

analysing the suggested asset health information against the benefits by scaling application of the methodology as required. In this guide, criteria are provided for the following asset classes:

- *Power transformers*
- *Distribution transformers*
- *Switchgear*
- *Support structures, and*
- *Underground cables.*

The above asset types represent a subset of the total assets of an electricity infrastructure provider. While it is hoped that further asset types will be specifically incorporated in future issues of this guide, users may if desired extend the approach to other asset types by locally developing further type specific criteria.

26. If the EEA asset health classification method is introduced for ID, a suitable approach for assets which are not covered will need to be determined. One option is to extend the proposed approach to other asset classes. Another option is to borrow from Ofgem's network asset indices methodology.
27. Paragraph 6.11 of the Companion Paper suggests that this amendment will apply from the 2019 year-end disclosures. This does not seem unreasonable.

Asset classes

28. It is proposed that the disclosure of information about each asset class is extended to include asset values. Currently asset class disclosures include quantity, grade and age information, whereas asset valuation information is disclosed at an asset category level.² The Companion Paper states that the purpose for the proposed amendment is to allow interested parties to assess the materiality of specific assets within a supplier's regulated asset base (RAB).

RAB is not a physical asset register

29. This proposal would, if implemented, suggest a direct link between the physical assets of an EDB and an EDB's RAB. However the asset valuation IM results in deviations between the actual physical assets in use (as reflected in the quantity, age and condition information) and value. This is because the RAB is effectively an investment value, which at any point in time reflects the unrecovered portion of a supplier's investment in its regulated assets. Thus:
 - assets may have been fully depreciated and hence have no value, even when still in use
 - assets may remain in the RAB after they have been removed from service
 - assets in use may have been optimised out of the RAB, or had their values 'optimised' for valuation purposes
 - assets for which capital contributions have been received will have lower values than those that have not
 - assets which have been vested may have no RAB value.
30. Accordingly attempting to align physical asset attributes and RAB values is likely to be misleading and hence of limited value to interested parties.

² There are multiple asset classes within an asset category.

Asset classes are not captured in the RAB

31. However, importantly it is also not possible for EDBs to report RAB asset values at an asset class level. This is because the current regulatory asset valuations, which were first established under the Commerce Commission's administration of Part 4A of the Commerce Act in 2004, were not prepared using the ID asset classes which were introduced in 2012. As the ID asset classes are more disaggregated than RAB valuation registers the proposed asset valuation information is not available.
32. The original 2004 valuations used standard asset categories with standard asset replacement costs. The asset categories were also grouped into standard asset life groupings.³ These standard asset life groupings applied from 2004 to 2009, although standard replacement cost categories did not. From 2009, the standard physical asset life categories specified in Schedule A of the IMs have applied.
33. Thus EDB RAB asset registers have been influenced by the various regulatory valuation asset categorisations which have applied since 2004. This has resulted in physical asset components (ie: asset classes) being grouped together for valuation purposes.
34. For example overhead line assets were valued in 2004 using standard replacement costs which incorporated the value of poles and conductors and other hardware such as crossarms. These were depreciated using different standard lives for wooden pole lines and concrete pole lines. However at no stage were conductors valued separately from poles or crossarms. Since 2004, there has also been no requirement for conductors and poles to be valued separately for RAB purposes.
35. We understand that asset class data (age, condition and quantity) for ID purposes is generally sourced from asset management systems including GIS databases, not RAB registers. This is why it is possible to extract the more disaggregated physical information at an asset class level. The RAB data is reported at the more aggregated asset category level (refer Schedule 4 of the EDB ID), for the reasons outlined above.
36. These categorisations were developed in 2012 by industry working groups in conjunction with the Commission. We propose they are retained, and the proposal for asset value disclosures by asset class is not adopted.
37. For the avoidance of doubt we do not support any attempt to pro rate asset values by asset class. We do not consider this would be meaningful, and it would add unreasonable cost and complexity to annual disclosures. We also do not consider that it is necessary to develop another set of asset categories for asset valuation information, given the disjoint between physical assets and RAB, as noted above.

Cross references

38. The marked up Draft EDB Amendments include a number of proposed changes to the cross references between the ID and the IMs. In general it is proposed that references to specific clauses to the IMs are removed and replaced with references to the subpart of the IM which contains the relevant clause. The Companion Paper does not explain why this change is proposed.
39. We do not support this revised approach to linking the ID and IMs. We consider that this reduces the usability of the ID, and it introduces unnecessary ambiguity. For example references to the IM subpart which contains the methods for depreciation is not sufficient for the ID depreciation definitions – of which there are a number of different types. It is the references to the clauses which provide the direct link to the appropriate definitions.

³ Refer Table A1 of the Commerce Commission's Handbook for Optimised Deprival Valuation of System Fixed Assets of ELBs, 30 August 2004

Amendments not considered

Matters deferred to future rounds of amendments

40. Attachment A of the Companion Paper includes a list of matters which could lead to future amendments of the ID determinations. It is a comprehensive list, covering a wide range of topics. These include matters which reflect:
- misalignment between ID and the Input Methodologies or Default Price-Quality Path Determinations
 - implementation issues, such as clarifications and inconsistencies, which have arisen as EDBs and other regulated suppliers have gained practical experience with applying the ID
 - policy issues, such as the ongoing review of related party transaction requirements
 - process issues, such as error corrections and ID assurance requirements.
41. The Companion Paper notes that the amendments which have been proposed as part of this current consultation are focussed on addressing consequential amendments to the ID determinations arising from the 2016 IM review. It also notes at paragraph 1.7 that future ID amendments will be ‘prioritised and phased to address other matters relating to airport services, EDBs, GPBs, GTBs and Transpower which we have deferred at this time’.
42. Section 2 of the Companion Paper includes discussion on how the proposed ID amendments were prioritised with reference to the statutory purpose of ID under the Commerce Act. This is interpreted in this context as including:
- the relevance of disclosure information and the importance of time series data (para 2.5)
 - the consistency between ID and IMs; future focus of the Commission’s summary and analysis work and complexity of the issues (para 2.7).
43. Unfortunately the Companion Paper does not explain why other matters which also meet these objectives have not been included in this round of proposed amendments. For example, if asset health is a high priority, then presumably asset performance is also. However the improvements to reliability measures which were introduced in the 2014 EDB DPP Determination have not yet been incorporated into ID.
44. One of the consequences of this is that non-exempt EDBs now prepare reliability statistics for each disclosure year using two different methods, both of which require Director certification and audit. Another consequence is that exempt EDBs are reporting asset performance outcomes using measures which do not reflect these improved methods - which are only reported by non-exempt EDBs for DPP compliance purposes.
45. A related issue is that the ID asset category remaining life metric is poorly specified, as it is unduly influenced by recent investments in new assets, and thus tends to overstate the remaining life of certain asset categories. Users of ID information may reach incorrect conclusions about asset health and performance if they rely on this measure in forming their views.

ID review overdue

46. We acknowledge the significant effort which the Commission has invested in developing the IDs, assessing compliance with them, developing and publishing ID databases and, more recently, developing and publishing targeted summary and analysis reports including:

- profitability analysis (published 2016)
 - performance summaries (published 2017).
47. ID regulation is the primary form of economic regulation for 12 of the 29 EDBs. It also applies to the remaining 17 EDBs in addition to price-quality regulation. Arguably it is the most important form of regulation for internal and external stakeholders because it is intended to measure the extent to which the purpose of Part 4 is being met by each individual regulated supplier (as per the s53A purpose of ID).
 48. However there is now a substantial backlog of ID issues which have not been addressed, as other work streams have regularly taken precedence within the Commission's work programme. Some of these issues are complex, and others less so. Some of them are more material than others. However there are now so many of them that there is a risk that the IDs are not adequately fulfilling their purpose.
 49. We therefore encourage the Commission to accelerate the ID amendment work streams to address the back log of issues which have built up. This will ensure the IDs are better able to meet their statutory purpose by providing high quality and relevant information for stakeholders. It will also remove compliance issues and therefore reduce compliance costs for the Commission and regulated suppliers.
 50. The EDBs which support this submission suggest that as part of an accelerated work stream, the Commission undertake a review of the ID determinations to confirm that they remain fit for purpose. It is now five years since these ID determinations introduced substantial changes to the ID framework for EDBs, including a significant amount of new information to be disclosed. We suggest it is timely, and good regulatory practice, to consider whether there are opportunities to remove, refine or supplement the information to be disclosed.

Next steps

51. We encourage the Commission to publish a programme of future ID work streams incorporating planned summary and analysis work, and ID amendments. This could include scope and timing for ID amendments and summaries, and how these are to be prioritised.