INFORMATION DISCLOSURE REGULATION UNDER PART 4 OF THE COMMERCE ACT 1986

Workshop 3:
Financial Disclosures 10 June 2011

Workshop Minutes

Venue

Kauri Room, Commission Offices
Level 6, 44 The Terrace,
Wellington.
Friday 10 June 2011, 9am–3:35pm

Participants

Anthony Merritt	Commission (Chair)
Simon Copland	Commission
John Groot	Commission
Hamish Groves	Commission
Vanessa Howell	Commission (sessions 1, 2, and 3)
Neville Lord	Commission
Geoff Evans	GasNet
Todd Campbell	Horizon Energy
Blair Robertson	Maui Development Limited (MDL)
Anna Moriarty	MDL
Jan de Bruin	Network Waitaki
Bruce Rogers	Orion (apologies)
Carla Graham	Powerco
Lynne Taylor	PricewaterhouseCoopers (PwC)
Nathan Strong	Unison / ENA
Richard Sharp	Vector
Greg Buzzard	Powernet

Introduction to Workshop

1. The Chair welcomed participants, noted the attendance of Jan de Bruin from Network Waitaki, and noted the apology from Bruce Rogers of Orion.
2. The Chair explained that the purpose of the workshop is to assist the Commission in preparing its draft determinations on information disclosure requirements for EDBs and GPBs.
3. The Chair noted that a number of matters are scheduled for discussion, all of which relate to ways in which the information disclosure requirements might best meet the purpose of information disclosure, which is to ensure that interested parties have sufficient information to assess whether the purpose of Part 4 of the Commerce Act 1986 (the Act) is being met. Specifically, the Commission wishes to consider how to minimise the costs of EDBs and GPBs complying with information disclosure requirements whilst ensuring sufficient information is available to interested persons.
4. The Chair noted that no formal post-workshop submissions will be requested, but participants are welcome to provide material following the workshop. Draft determination(s) and a reasons paper (which will include the draft financial disclosure requirements) are expected to be released in September 2011 for formal consultation. The Chair noted that the Commission expects the final ID determination would apply for disclosures commencing from the disclosure year 2012.
5. The Chair noted that the workshop draft agenda was circulated on 24 May and the final agenda on the 8 June.
6. The Chair also noted:
   i. the Commission's approach to the term 'interested persons' includes, but is not limited to, consumers, suppliers and owners of the regulated suppliers, regulatory bodies including the Commission and any other stakeholder of a regulated supplier. The Commission is an interested person because it uses disclosed information in meeting its summary and analysis obligations under s 53(b)(2)(b) of the Act.
   ii. that the Commission does not discriminate between groups of interested persons, nor does it presume what interested persons may do with disclosed information; rather it views its role as ensuring that the information is transparently disclosed, in sufficient detail that IPs can assess whether the Purpose of the Act itself is being met.
   iii. The Commission's approach to determining financial information disclosures relies heavily on the approach and templates that have been used previously including under the current EDB ID regime, and in respect of information requested to inform the SPA process. It was noted that this approach represents a bigger change for GPBs.
   iv. No party expressed any concerns around the agenda or the potential disclosure of any confidential information.

Session 1: Related Parties

7. The Commission noted that the purpose of ID is to ensure interested persons have sufficient information available to assess whether the purpose of Part 4 is being met. When transactions are being entered into by related parties, interested persons need to understand how the information disclosed is affected by the related party transactions.

8. It was noted that the current EDB disclosures included related party transactions totalling $270 million annually, or around 29% of combined capital and operating expenditure.
9. In summary, the Commission noted the extent of related party transactions ranged from none to 80%.
10. The Commission noted its concern was to ensure interested parties could use the information disclosed under ID knowing that the costs had not been affected by the related party nature of some transactions, or that there was sufficient information for an interested person to make an adjustment to the disclosed information to remove the impact of the related party transaction.
11. Attendees were invited to outline the extent to which they undertook transactions with related parties, and how prices under such transactions were determined. Comments made included:
    i. Network Waitaki maintenance was undertaken by a related party. That business also serviced some other parties, with around 80% of the work provided to the regulated business. Charges to the EDB were the same as for anyone else.
    ii. MDL is a bare nominee company. There were three key contractual relationships: system operator, commercial operator, and Technical operator. The operators are not related parties. This may change in future, and some potential business opportunities could involve related parties. Gas balancing activity could involve small purchases from related parties, but prices were determined from a web-based trading facility.
    iii. Horizon, like Waitaki, had a contracting business which had internal and external work. It competed for resources, and paid market rates for such resources. Capex levels in the regulated entity had not been high. The contracting business was relatively small, though it was looking to grow, and work for the regulated entity represented around 80% of its work. Prices were set taking market rates into account, and it was noted that it was difficult to attract external providers to provide services.
    iv. Powernet also had difficulty in getting external providers, due to its location. It had tried contracting out services, but had been bringing them back in house. Historically, Powernet considered that the external providers had failed to invest in staff, systems, health and safety. Powernet was prepared to pay for higher quality. Transfield provided a benchmark arm's-length price. Across the networks Powernet managed, there were four geographically-based contracts, two with external providers and two with related parties (though the shareholding between the service provider and the regulated entities differed).
    v. PwC noted that the industry adopted two broad models. A fully contracted out model, possibly with more than one provider (selected by tender) and a model including the use of related party providers, whose involvement could vary.
    vi. Vector had an outsource model for electricity. Related party transactions were mainly around tree-trimming (Treescape was a nationwide business owned 50% by Vector), and competitive prices were charged. In gas, the delivery of gas for wholesale and retail services could involve related party transactions. These were done on an arm's-length basis. Gas could be purchased for line-packing on the basis of a competitive price. There was not a lot of related party operating

expenditure. An issue in meeting the requirements was to satisfy confidentiality concerns, including margins on competitive businesses.

vii. Unison had a contracting business providing services to Unison and other networks. The motivation for this was to get the right level of service. Unison had not been satisfied with the health and safety outcomes achieved by external contractors. External consultants were used to assess market prices for services from related parties. Around 80% of the contracting business' work was provided to the regulated entity.

viii. Powerco had sold its contracting arm in 2005. Had one contractor now in a partnership agreement (which had expired). All transactions were therefore on an arm's-length basis.

ix. Gasnet had a very low level of related party transactions which included, for example, insurance being retained at the shareholder level after Gasnet and Energy Direct were established as stand-alone companies.

12. Attendees noted that the asset valuation IM included a provision relating to the value at which an asset acquired from a related party entered the RAB, and noted that the issue may turn on the meaning of the word "acquired" in the IM. In particular, whether this covered only assets that were acquired from a related party, or whether it also covered assets constructed by a related party.

13. The Commission noted the Ofgem approach, (where the value disclosed was at cost to the related party supplier, unless it provided at least 75% of its work to non-related parties and charged the related party the same price), and asked whether this might be an appropriate option. PwC noted a concern that this could create differences in charges between EDBs, where prices from an external party could contain a profit margin, but not on related party transactions. Unison considered the Ofgem approach could destroy value in the contracting business, which may therefore be sold instead.

14. The Commission expressed a view that the objective was to ensure the effects of different transaction values arising from a related party transactions were, or could be, removed, rather than to change commercial performance.

15. Attendees noted that it was difficult to prove an arm's-length price. Tenders were not always possible due to the nature of the service, external providers were not always interested in participating, and suppliers needed a base level of work to be able to compete. It was suggested that the Commission could rely on audit assurance that transactions were on an arm's-length basis. PwC agreed to provide information to the Commission on how auditing standards could be used to establish whether a price was on an arm's-length basis.

16. The Commission asked for elaboration on the confidentiality issues concerning related party transactions. Attendees considered this was not a concern if the disclosure was on the gross value of related party transactions. However, some contracts may restrict the disclosure of prices.

17. Some attendees also enquired whether the disclosure of hypothetical arm's-length prices, rather than the actual values agreed for performing a service, was consistent with the spirit of the ID regime.

Session 2: Consolidation statements

18. The Commission noted that the purpose of ID is to ensure the purpose of Part 4 of the Act is met. The Commission noted that a lot of effort had been invested in developing the rules and methodology and it was important to ensure the information disclosed complies with the requirements. The Commission noted the Act provides a number of means to ensure compliance including certificates, declarations, audit requirements and consolidation financial statements. Each provides some assurance that the information complies with the requirements, but none is perfect. The Commission considers the consolidation statements may provide additional assurance that the information disclosed complies with the requirements. In particular, consolidation statements make transparent how much of the difference between GAAP and ID information is due to GAAP and regulatory reporting requirements and how much relates to non-regulated activities. Consolidation statements also enable analysis to be undertaken.

19. The session addressed two topics: should consolidation statements be required, and if so, what specifically should be required. It was acknowledged that these are related issues.

20. Workshop attendees who represented EDBs and GPBs strongly opposed the requirement for consolidation statements. In particular:

    i. Unison “really struggled” to see how the Commission would use the information in a consolidation statement to monitor compliance.

    ii. Vector noted the additional work from having to prepare a consolidation statement in respect of years which did not align. This included repeating the work (e.g. cost-allocation), and re-auditing.

    iii. Some participants considered that the independent audit provided sufficient assurance that the information complied with the requirements;

    iv. PwC noted that the templates provided additional supporting information which also provided assurance that the information disclosed complies with the requirements;

    v. PwC noted the cost allocation schedule contained very detailed information and questioned how the consolidation statement would add any further insight;

    vi. GasNet considered it ironic to require a reconciliation to GAPP when the Commission had made a deliberate decision to depart from GAAP;

    vii. Powerco was concerned over the different balance dates and the difficulty in reconciling information between the ID requirements and that under GAAP; and

    viii. PwC noted the quantum of information that was already required under the requirements and did not want to see further information required especially where it did not go to the heart of the purpose.

21. In terms of how any requirement for a consolidation statement would be framed:

    i. attendees expressed a particular concern with being required to reconcile asset registers (with implications for depreciation), and for reconciling tax expense;

    ii. Powernet noted that IFRS had made GAAP more complex and the extreme difficulty of reconciling numbers between GAAP and ID, especially given Powernet’s JV’s and investments;

iii. MDL noted it was a bare nominee company, with no assets, and questioned how it could reconcile tax expenses; and

iv. Horizon noted its non-regulated businesses were small (less than 5% of assets) and questioned whether a consolidation statement was necessary. Other participants noted that a reconciliation of GAAP and ID could still be undertaken.

Session 3: Information disclosure after a sale, merger or acquisition

22. It was noted that merger and acquisition costs can be significant, although such large transactions were relatively infrequent. Vector had undertaken three such transactions in the last nine years.

23. It was noted that mergers and acquisitions would benefit consumers over time. As such, it was appropriate the costs should be included in the calculation of regulatory profit.

24. There was a discussion on whether such costs should be spread over several periods or only in the year they are incurred. Spreading over several years was considered more likely to reflect the timing of merger benefits, and avoid the peakiness of such transaction costs affecting the time series of data. However other participants suggested that as it was arbitrary to spread the cost over time, and they should be allowed in a single year. It was noted that so long as the amounts of such costs were disclosed, it was possible for readers to adjust their impact on profits or total expenses to reflect a variety of scenarios.

25. Unison expressed a view that the wider regime did not encourage mergers and acquisitions and questioned whether it was premature to consider how to recognise the costs of consolidation activity.

Session 4: Draft Financial Template Schedules

26. This session addressed the draft financial disclosure template schedules circulated to workshop participants as part of the draft and final agenda.

27. The Commission explained that the draft templates were intended to be consistent with all of the input methodologies (IMs) released in December 2010 as applicable to EDBs and GDBs/GPBs, and took the best examples of disclosure formats from the SPA information request templates, the existing EDB ID templates, and the airport ID templates.

28. The session started with a discussion of suppliers' experiences with completing disclosure templates, to discover what works, what makes it harder to populate the templates.

29. Workshop participants:

i. noted that spreadsheet templates were a good step forward compared to the preparation of full financial statements and helped to ensure consistency of disclosure between suppliers;

ii. definitions for each line item in the templates were seen as desirable and it was noted that the definitions included in the IMs could be hard to locate and use;

iii. PwC suggested that all of the information presented may not be intuitive or useful from the perspective of an interested person (e.g. a trustee) and that the Commission should keep in mind the primary purpose of information disclosure. For example, is it necessary to disclose detailed calculations or these calculations

be presumed to be subject to adequate checking through review and audit processes and therefore be excluded from the templates;

iv. it was noted that the previous EDB disclosure templates did not cater adequately for the disclosure details of Vector's sale of its Wellington business to Wellington Lines;

v. sought intermediary guidance in completing the templates. In terms of what form this should take most attendees considered this should include actual definitions (not just references back to the IMs), though some considered a handbook or guideline book could be included, and raised the possibility of periodic industry workshops to increase awareness of technical issues;

vi. GPB attendees noted that some categories were foreign to GPBs, e.g. expense categories;

vii. enquired whether breakdowns of totals were necessary, e.g. of operating expenditure;

viii. Attendees with experience of the SPA information request process supported the use of the on-line issue register used in that process;

ix. suggested independent auditors were not fully conversant with the IM and associated requirements. This could continue to be the case over time as those auditors that with knowledge of the requirements change firms or leave the industry;

x. In terms of directors' familiarity with the requirements, it was suggested that Boards tend to place heavy reliance on management and auditor assurance;

xi. suggested that the templates be future-proofed as far as possible, for example, to reflect information that would have been useful for making future starting price adjustments under default price-quality path regulation, or to support the information requirements for the Commission's summary and analysis;

xii. noted that the intention that the 'non-public' schedules were for release to the Commission only. It was asked whether these schedules might nevertheless be disclosed pursuant to an Official Information Act request.

Comments on individual Schedules

Schedule 1a

30. Participants discussed whether the ROI information for the disclosure years ended 2010 and 2011 should be disclosed. PwC considered that this would not be valuable as the existing prior year ROIs were prepared under the current (soon-to-be-superseded) rules. As ROI calculations became progressively available under the new regime it would be possible to show ROIs for previous years.

31. Participants discussed whether schedule 1a should include a statement of whether a supplier under a DPP had complied with the price path. Some participants could see that this might be useful, but it was also suggested this may duplicate the DPP compliance statement.

Schedule 1b

32. Attendees considered that, unlike airports which may have a small number of projects, EDBs and GPBs could have a large number of projects making disclosure on a project by project basis as required by draft Schedule 1b difficult or impractical. Potential solutions were to establish monetary or materiality thresholds for what constitutes a 'project', or to disclose total projects commissioned by month or quarter.

Schedule 2

33. Attendees asked why pass-through costs were split out. It was noted that these were not previously treated as a separate component in the classification 'operating expenditure'.
34. PwC suggested that sub-totals should be shown for pass-through and recoverable costs.
35. It was noted that there was approval process for avoided transmission costs, but these should be included in ID.
36. Someone asked how the disclosures are consistent with the intent to allow some of the benefit of avoidable transmission costs to be kept by suppliers for a period, e.g. five years. The Commission would consider this further.
37. PwC suggested that the disclosure of the amount of discretionary discounts were of interest to trusts (for example) and should therefore be separately disclosed for information purposes on Schedule 2 (rather than just disclosed in the regulatory tax allowance section).
38. Attendees questioned whether the distinction between "other regulatory income" and "other operating revenue" was necessary or appropriate.
39. MDL asked whether consideration could be given to the disclosure of revenue from balancing activity matched with the recoverable costs so as to show a net amount only (rather than be shown separately as a revenue and expense item).
40. It was noted that capital contributions no longer form part of revenue.
41. Participants noted that the current EDB related-party disclosure requirements purported to capture operating and capital items but was currently shown as a note to the operating statement.
42. It was suggested that schedule 2(c) may be redundant as it was not widely used under the existing EDB disclosures.

Schedule 3

43. More space should be made available for "general management" and "other" expense items, and less space was required for the remaining categories, given that asset-related categories of expenditure were less likely to involve a cost allocation.
44. The meaning of the "line item" column in Schedule 3 was queried. The Commission clarified that this was intended to align with the definition of "line item" provided in the IMs which referred to the asset categories typically employed within management accounting systems.
45. PwC noted that there was no specific category within the Schedule for allocating pass-through or recoverable costs.
46. Commission noted that the total use of ACAM, ABAA, and OVABAA should add to 100% on each line item.

47. The Commission suggested that the statement should include disclosure of the key indicators for determining compliance with the cost allocation materiality screening threshold standards.
48. It was noted that directly attributable expenses to the unregulated business were not disclosed.
49. Attendees asked why a separate category was shown for "CY + 1". This implied that a forecast of expenditure would be required and was therefore thought to be unnecessary.
50. A typo was noted – reference to Schedule 10 should be to Schedule 3.

Schedule 4a

51. Schedule AV1 in the current EDB disclosure requirements was seen as providing a useful view of the regulatory asset base (RAB) time series, and a similar approach should be included in the new requirements as it explained changes in the RAB over time.
52. Attendees commented that disclosure of the 'unallocated' RAB and 'allocated' RAB was confusing for suppliers in preparing the disclosures, and would confuse users. PwC had received many queries on this. The Commission noted that calculation of the unallocated RAB was necessary under the IMs to calculate the RAB, which ultimately formed the basis for the RIV calculation.
53. It was noted that alternative depreciation method was applicable only if the supplier was subject to a CPP.
54. CPI rates would be populated by the Commission before the templates were issued.
55. Attendees queried whether works under construction should be included. The Commission noted that this was required in order to link to the AMP (which contains forecasts of capital expenditure, rather than "assets commissioned" which enter the regulatory asset base). It was suggested this should be considered in light of the AMP requirements in due course.
56. The Commission suggested that disclosure of the amount of capital contributions and the market value of vested assets might be a useful addition for interested persons, and may be advantageous for suppliers in explaining the relationship between maintenance and ongoing costs relative to asset values. Attendees suggested that assigning a market value to vested assets was problematic and that wider consultation may be necessary if disclosure of vested asset values was thought necessary.
57. Attendees questioned whether the current asset disclosure categories, which were referenced to the ODV handbook, were still appropriate. With the move away from reliance on the ODV handbook, they were no longer needed.

Schedule 5

58. Attendees queried whether the asset categories were appropriate and whether suppliers might be better to define their own asset categories.
59. MDL noted it had discussed the appropriate asset categories for itself in its CPP submissions during the IMs consultation phase.
60. The additional text box in Schedule 5c should probably refer to "asset allocations" not "cost allocations".

Schedule 6

61. PwC noted the terminology differed between the IMs, with respect to permanent and temporary differences. The value in disclosing “workings”, and what this actually entailed, was also questioned.

62. The Commission noted that it was necessary to track deferred tax balances coming with assets transferred from other EDBs pursuant to the IMs.

63. PwC considered that retaining the deferred tax balance roll-forward calculations for the 2010 and 2011 disclosure years is important.

Schedule 7: Term credit spread differential

64. The Commission noted that the disclosure of the coupon rate was intended to be an identifier of bonds only. Attendees noted that some information provided under these disclosures might be considered confidential, e.g. under some private placement arrangements.

Schedule 8

65. It was proposed that the establishment of an initial RAB may be a once-only disclosure (i.e. in the 2012 disclosure year).

66. Attendees commented that the double-column offset style of Schedule 8b makes it somewhat confusing and preferred a single column format or a format that replicates the Schedule AV1 in the current EDB disclosure requirements.

67. PwC considered favoured the inclusion of a five year RAB roll forward history as it provided valuable information (see comments for Schedule 4a above).

68. Schedule 8(c)(ii) (works under construction) may not be necessary.

Schedule 9

69. Attendees noted new line items had been introduced covering forecast expenditure on other capital expenditure (non-asset related) and for operational expenditure items.

70. Vector suggested that requiring prospective financial information could be problematic, including obtaining an assurance opinion from an auditor. PwC explained that this was not an issue in respect of asset-related information, as the policies and other information in support of this information were included in the AMP. However, there was nothing to support disclosure of the forecast of “other” information noted above.

71. MDL noted the confidentiality of demand forecasts given to them by shippers.

Schedule 9b

72. Horizon asked whether the materiality threshold should be amended to refer to a “% of the total” test as well as a “% of the category” test.

Other Matters

73. PwC suggested that a review of the non-financial Schedules (MP1, MP2, and MP3) would be desirable with a view to assessing their relevance and possibly reducing the amount of information disclosed in this area.

74. The Commission noted the areas where changes to the draft schedule templates to accommodate GPB-specific requirements had been made, and asked attendees to

identify any other matters that would allow the schedules to be adequately tailored for GPBs. None were identified at the workshop.

Conclusions and next steps

75. In his closing remarks the Chair thanked attendees for their assistance and participation.

76. Draft minutes would be prepared and circulated to attendees for review before these were made more widely available. No formal post workshop submissions were requested, but participants were welcome to provide material after the workshop. The Commission aimed to release a draft determination and draft reasons paper by September 2011 for consultation.

77. The workshop closed at 3.35pm.