MAJOR ELECTRICITY USERS' GROUP

4th February 2016

Keston Ruxton
Manager, IM Review
Commerce Commission
By email to regulation.branch@comcom.govt.nz

Dear Keston

Submission on Emerging technology pre-workshop paper: 30 November 2015

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission paper "Input Methodologies review – Emerging technology pre-workshop paper" dated 30th November 2015. Other relevant materials are the slides presented to the workshop on 14th December, the transcript of the workshop and materials tabled by Contact Energy, Powerco and MEUG before and or at the workshop[1].

2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.

3. MEUG has no view as yet on the question themes raised in the pre-workshop paper such as whether the current balance between flexibility and prescription in the cost allocation IM is fit for purpose for emerging technologies[2]; nor do we have any further examples to test in addition to those considered at the workshop[3]. We will review those themes after considering the submissions of other parties.

4. The materiality screening tests set in 2010 should be reviewed[4]. There are three reasons to review the screening tests. First the 2010 decisions used historic data up to that date. It would be prudent to consider data over the last 5 to 6 years. Second there have been several years of disclosures on actual practice that might give insights into the level of screening tests. That suggestion is discussed further in paragraph 7 a) below. Third there may be different business models adopted by distributors for un-regulated businesses that might not fit within the 2010 approach to deciding screening tests. An example of that is discussed in the next paragraph in relation to new lease accounting standards.

[1] All materials at http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/emerging-technology/
[2] Pre-workshop paper question in paragraph 136.
[3] Ibid paragraphs 140 to 142.
[4] Ibid paragraph 137.

5. New Zealand has just adopted the International Financial reporting Standard 16 Leases or "NZ IFRS 16" as it is used in shorthand. NZ IFRS 16 does not come into effect until 31st December 2019 and then only for large entities; this though will be within the timeframe for any revised IM allowing for early adoptions[5]. The treatment of leases by monopolies has often been a difficult issue. For example Transpower had a sale and lease back arrangement for the HVDC several years ago that even today nobody other than those inside Transpower could understand. Another example is the practice overseas of airports being subject to "leases" and the complications that gives rise to estimating the appropriate entity leverage for cost of capital purposes. MEUG raised this issue in setting the 2010 cost of capital IM. The treatment of leases for regulated airport services in New Zealand was identified in the IM problem definition phase last year; though the Commission has classified that as an information disclosure topic rather than an IM issue[6]. That classification as an information disclosure topic may be appropriate for airport services but not for energy line services. With emerging technologies there may be business models distributors use that employ leasing arrangements. There should be careful consideration of the implications for the cost allocation IM.

6. The question in paragraph 143 asks "Do you think that additional R&D or innovation incentives are needed? And if so, what?

   MEUG assumes R&D or innovation incentives for provision of regulated line services will be considered under the separate work streams on risk of partial capital recovery and efficient investment incentives noted in paragraphs 11.1 and 11.2 of the pre-workshop paper along with the findings from the concurrent work on cost of capital and the yet to commence risk allocation work stream. MEUG is unaware of any market failure reason to support consideration of giving distributors R&D or innovation incentives for non-regulated emerging technology services.

7. Finally MEUG has general concerns whether interested parties are able to assess whether the purpose of Part 4 is being met in a timely manner with high-quality performance metrics. The advice by the Commerce Commission of a work stream[7] on consumer engagement is welcome and should in tandem with the information disclosure requirements improve consumers understanding of regulated services. In the context of improving the understanding by users of regulated services on the effectiveness of the cost allocation IM MEUG suggest two changes to information disclosure requirements:

   a) A specific piece of work by the Commerce Commission to analyse the cost allocation practices of regulated electricity and gas service providers to inform the review of the screening test (as noted in paragraph 4 above) and whether the current balance between flexibility and prescription is working.

[5] A good summary of NZ IFRS 16 is an article by Jackie Russell-Green in the NZ Herald, New lease accounting changes hit balance sheets, 22nd January 2016, refer http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11576857

[6] Commerce Commission slides, Airports IM review, Profitability assessment workshop, 1st December 2015, slide 58, document URL http://www.comcom.govt.nz/dmsdocument/13952 found at http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/input-methodologies-review/airport-profitability-assessment/

[7] Commerce Commission, Input methodologies review, process update paper, p5, 30th October 2015, URL http://www.comcom.govt.nz/dmsdocument/13833

b) A review made of the Commerce Commission decision[8] in 2012 not to require regulated suppliers to disclose regulatory consolidation statements. If an unregulated business grows rapidly and or becomes more material to an entity than the regulated business there is a risk cost allocation practices will quickly become outdated. In that event either unforeseen or even deliberate finessing of the cost allocation IM will allow cross-subsidies from the regulated to un-regulated businesses even if only temporarily.

Problems with interested parties being to unbundle regulated from unregulated businesses were noted by Ireland, Wallace & Associates Limited in their report to MEUG of 29th August 2014 in relation to RAB multiples[9], eg (paragraph 4.2) "the assessment of the financing of a Regulated Business is problematic particularly for Vector" and (paragraph 6.1) "Vector is a mix of regulated and non-regulated business. Unlike Powerco, Vector's balance sheet needs to be deconstructed to establish a best estimate of its regulated businesses given publicly available information." Those problems with misalignment of balance dates and inclusion of different items (eg goodwill) for financial reporting differing from those for the economic regulatory disclosures inevitably give rise to uncertainty as to whether the optimal long term benefit of consumers is being achieved.

Yours sincerely

Ralph Matthes
Executive Director

[8] Commerce Commission, Information Disclosure for Electricity Distribution Businesses and Gas Pipeline Businesses: Final Reasons Paper, 1st October 2012, paragraphs 3.115 to 3.117, URL http://www.comcom.govt.nz/dmsdocument/9531 at http://www.comcom.govt.nz/regulated-industries/electricity/electricity-information-disclosure/current-electricity-information-disclosure-requirements/

[9] Ireland, Wallace & Associates Limited, Commerce Commission's Proposed Amendment to the WACC Percentile for Electricity Lines Services and Gas Pipeline Services dated 22 July 2014, Report to MEUG, 29th August 2014, URL http://www.comcom.govt.nz/dmsdocument/12377