

COMMERCE

MINISTRY OF COMMERCE
Te Manatū Tauhokohoko

DISCUSSION PAPER

**PROPOSALS FOR AMENDING
THE ELECTRICITY (INFORMATION DISCLOSURE) REGULATIONS**

Energy Markets Policy Group
Resources & Networks Branch
Ministry of Commerce

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DISCUSSION PAPER

PROPOSALS FOR AMENDING THE ELECTRICITY (INFORMATION DISCLOSURE) REGULATIONS

1 This discussion paper sets out the Ministry of Commerce's ("the Ministry's") specific proposals for amending the Electricity (Information Disclosure) Regulations 1994 ("the Regulations"). The Ministry's proposals fall into the following categories:

- amendments arising as a result of recent industry reforms;
- amendments to line charge disclosure requirements;
- amendments aimed at increasing focus on line business reliability and security;
- amendments which are intended to make disclosed information more accessible to the general public; and
- amendments to ensure that the financial statements disclosed under the Regulations comply with generally accepted accounting principles (GAAP), and to improve the definitions for calculation of financial performance measures.

2 It is intended that these amendments would take effect from 1 April 1999.

Comments sought on this discussion paper

3 We would appreciate any comments by 19 October on the proposals in this discussion paper. Comments should be sent to:

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4 Respondents should note that written comments provided to the Ministry in response to this discussion paper will be among the information we hold which is subject to public release under the Official Information Act 1982. If the Ministry receives a request for this material we will be required to consider its release, in whole or in part, in terms of the criteria set out in the Act. The Act requires us to make the information available unless we consider that there is good reason, pursuant to the Act, to withhold the information, and that good reason outweighs the desirability, in the public interest, of making the information available. The grounds for withholding official information are set out in the Official Information Act.

5 In providing your comments, please advise the Ministry if you have any objections to the release of any material and, if you do object, the specific material that you would wish withheld, and the grounds for withholding. The Ministry will carefully review any representations that you make in this regard in considering any formal Official Information Act requests that might be received in the future relating to this material. You should note, however, that the decision on release rests with the Ministry. Any decision to withhold information is subject to appeal to the Ombudsman.

PROPOSED AMENDMENTS ARISING FROM INDUSTRY REFORMS

Removal of disclosure requirements applying to ECNZ

6 Given that none of the ECNZ successor companies will be dominant in the generation market, the Ministry proposes that the specific disclosure requirements applying to ECNZ be revoked following a final Government decision, expected in December, to proceed with plans to split ECNZ into three competing SOEs. Specifically, the Ministry proposes that, when the split takes place:

- Regulation 4, which requires ECNZ to disclose financial statements, be deleted; and
- the parts of Regulations 7 and 8, which require ECNZ to disclose prices, terms and conditions of its generation contracts or arrangements, be deleted.

Continuation of disclosure requirements applying to line businesses

7 The separation of line businesses from retail/generation businesses will have no impact on the regulatory concerns arising with natural monopoly line activities. Accordingly, the Ministry proposes that the current disclosure requirements applying to line owners be continued. Specifically, all line owners will continue to be required to:

- Disclose financial statements and performance measures covering their natural monopoly line businesses (Regulation 6): From 1 April 1999, line companies will be precluded by the Electricity Industry Reform Act from being involved in significantly-sized generation or retail activities. They may, however, be involved in any other contestable activities.

The mandatory avoidable cost allocation methodology (ACAM) (that applies for 1998/99) has been amended to the extent required to reflect this. A draft of the ACAM for line businesses is in Annex 1. The financial statements for the line business produced using this draft, for 1999/2000, will be comparable to the line business statements produced in 1998/99.

Further to the requirements of the Electricity Industry Reform Act, it should be noted that no items arising from hedge contracts for risks relating to the price of electricity in New Zealand are to be allocated to the line business financial statements. Such items (depending on the circumstances and accounting treatment) might include assets or liabilities, and losses or gains (they might also include costs arising from guarantees relating to performance under hedges). This allocation requirement is covered by the mandatory ACAM, as set out in Annex 1. Any such items are to be allocated to "Other".

- Disclose prices, terms and conditions for supply of line services (Regulations 9 and 10): No changes are proposed here.
- Disclose line charges and line charge methodologies (Regulations 18, 22 and 23): The Ministry is proposing some amendments to these requirements, as outlined in paragraphs 13-16 below.

Amendments to disclosure requirements applying to retail and generation activities

8 The reforms of the electricity industry will promote retail competition in two ways:

- full ownership separation of line and retail activities will address concerns about line businesses subsidising their retail activities and restricting access to their lines by competing retailers; and
- after the introduction of a low-cost switching system on 1 April 1999, retailers will invite competitive entry if they seek to overcharge smaller retail customers in order to subsidise larger retail customers.

Discontinuation of requirements for retailers and generators to disclose contracts and performance measures

9 Certain existing or proposed disclosure requirements were intended to make dealings with retail customers more transparent. The Government's electricity reforms will remove dominance of the generation and retail markets and should (inter alia) eliminate retailers' ability to overcharge smaller retail customers. Accordingly, the Ministry proposes that, after 1 April 1999, the following requirements will not be required:

- Retail contracts: The requirement in Regulations 11 and 12 that retailers which are in a prescribed business relationship with a line owner disclose prices, terms and conditions for supply of retail services.
- Retail performance measures: Amendments requiring disclosure of financial and efficiency performance measures for combined line and retail services, amongst those being introduced for 1998/99.
- Incremental revenue for retail: Amendments requiring retailers to disclose details of the revenue they obtain from small, medium and large electricity retailing customers, amongst those being introduced for 1998/99.
- Generation contracts: The requirements on generators in prescribed business relationships with line owners (in Regulations 7 and 8) to disclose prices, terms and conditions of their generation contracts, including imputed prices for electricity purchased by the related retail business. (Note that while line and generation activities are in common ownership, however, the line business financial statements will continue to be required to include details of any transfers to the generation business for avoided transmission or distribution costs.)

Continuation of financial statement disclosure by retailers and/or generators in common ownership with line companies

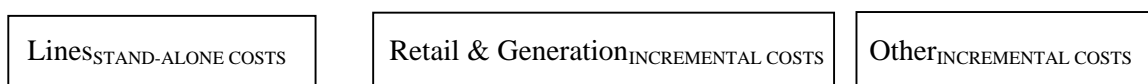
10 After 1 April 1999, line and supply companies which are owned by settling and mirror trusts, or which have adopted corporate separation pending full ownership separation, may continue to have incentives to subsidise their contestable retail and/or generation activities from their line businesses.

11 Accordingly, the Ministry proposes that, in addition to the requirement for line companies to disclose separate financial statements for their line activities (as outlined in paragraph 4 above), supply companies which are owned by settling or mirror trusts or which have adopted corporate separation, will be required to disclose a single set of financial statements covering the incremental costs, revenues, assets and liabilities of their combined retail and generation activities.

Financial statement disclosure model under ownership separation (see para 4 above)



Financial statement disclosure model under mirror trust or corporate separation



A draft methodology for allocation of costs, revenues, assets and liabilities between supply companies' retail/generation and "other" activities is included in Annex 1.

12 Once the owners of these companies comply with ownership separation, disclosure of financial statements for retail and/or generation activities will no longer be required.

Proposals for amending transfer payment disclosure requirements

13 Regulation 20 requires disclosure of prices, terms and conditions for transfers of goods and/or services between businesses which are in prescribed business relationships with each other. The rationale for this is that inappropriate pricing of transfers between business activities provides considerable scope for hiding monopoly profits or cross-subsidising contestable activities from non-contestable activities. The Ministry proposes that, in the light of separation, Regulation 20 be amended to ensure that it requires disclosure of details of transfers between:

- line and "other" businesses with which they are in a prescribed business relationship, such as asset construction businesses (this may require an amendment to section 170(1)(ha) of the Electricity Act 1992); and
- line and retail/generation companies which are in common ownership (that is, mirror-trust owned companies and companies subject to corporate separation prior to full ownership separation).

Level of aggregation of transfer payments for asset construction and maintenance work

14 In order to enable scrutiny of the appropriateness of intra-company transfer payments from a line business to their “other” business for asset construction (provided by another section of the company), the Ministry proposes that line owners be required to disclose disaggregated details of these, in the following categories: (i) subtransmission assets; (ii) substations; (iii) lines; (iv) MV switchgear; (v) transformers; (vi) substations; (vii) LV reticulation; and (viii) other system fixed assets, as categorised in standard asset tables in the ODV Handbook.

Proposal for amending requirement for disclosure of amount of electricity conveyed on behalf of other persons

15 Following ownership separation, the requirement in Part III of the First Schedule of the Regulations for line owners to disclose the total amount of electricity conveyed through their lines on behalf of “other persons” will not be meaningful. All electricity retailers will be separate persons from line companies. In order to assist in monitoring the development of retail competition, the Ministry proposes that line companies instead be required to disclose the amount of electricity they have conveyed annually on behalf of different retailers supplying customers on their network. The line company would not be required to disclose the names of the retailers, just the amount conveyed on their behalf. For example: Retailer A, 5 GWh; Retailer B, 6.5 GWh; etc.

PROPOSED AMENDMENTS TO LINE CHARGE DISCLOSURE REQUIREMENTS

Regulations 22 & 23

16 Regulation 22 requires any line business or retailer that invoices any consumer for any line charge to: (i) publicly disclose details of line charges; and (ii) provide written notification to customers of details of their line charge. This disclosure/notification is required both annually and whenever charges are changed.

17 The objective of this disclosure is to facilitate comparisons of different businesses’ line charges and to facilitate competition by ensuring that the unavoidable part of customers’ bills is known. In order for customers to assess the appropriateness of their line charge, information about the line charge imposed by the relevant line business in respect of that customer is required.

18 The following problems arise with the current wording of Regulations 22 and 23:

- Regulation 22 requires disclosure of the charge imposed on the final customer. In some cases, this charge may have been rebundled by the retailer, rather than being the line charge imposed by the line business in respect of that customer.
- Regulation 23 provides that parties subject to Regulation 22 may impute line charges. Imputed line charges are unlikely to be identical to the line charges actually imposed by the line business, and therefore will be of limited use.

- Regulation 22 requires disclosure of “...the amount [of the line charge] that represents the line charge imposed by each other person...” This means that the amount of the line charge which represents Transpower charges must be disclosed. Given that Transpower does not impose transmission charges on a per customer basis, these line companies must be imputing the Transpower component. This is effectively an arbitrary allocation of Transpower charges, which does not provide useful information.

19 Accordingly, the Ministry proposes that Regulation 23 be revoked, and that Regulation 22 be amended to:

- require line companies (rather than retailers) to disclose line charge information;
- make it clear that imputed Transpower charges need not be separately identified in this disclosure;
- require that, in relation to *standard contracts* (as defined in the Regulations), line companies must:
 - ⇒ publish line charges in local newspapers and on the Internet;
 - ⇒ advise line charges to any person requesting the information;
- require that, in relation to *non-standard contracts*, line companies must provide line information in the same manner as for standard contracts, except that:
 - ⇒ publication in local newspapers would not be required; but
 - ⇒ line companies must advise line charges to final consumers (this might be done either directly or by arrangement with retailers);
- require disclosure of line charges only when they are changed, and not annually;
- require disclosure at least 20 working days prior to the change taking effect; and
- require disclosure of both the new and old line charges (together).

PROPOSED AMENDMENTS DESIGNED TO ENSURE THAT LINE COMPANIES PROVIDE AN APPROPRIATE LEVEL OF SECURITY OF SUPPLY

Proposals resulting from review of OFFER’s performance measures

20 The Ministry has compared the current reliability performance measures in the Regulations with those used by OFFER in the UK. The Regulations already include most of the performance measures used by OFFER, but we propose that:

- OFFER’s more user-friendly reliability terms - “Overall reliability” (instead of “faults per 100km”), “Security” (instead of SAIDI) and “Availability” (instead of CAIDI) be adopted in the Regulations; and

- the Regulations require disclosure of “Proportion of interruptions not restored within 3 hours” and “Proportion of interruptions not restored within 24 hours”, as required by OFFER.

21 These proposals will require amendments to the reliability performance measures in the First Schedule to the Regulations.

Disclosure of asset management plans

22 It will be recalled that the Ministerial inquiry into the Auckland power failure was critical of Mercury Energy’s asset management planning and practices.¹ The inquiry team recommended that the Government consider requiring publication of asset management plans as part of the disclosure regulations.² The Minister of Energy announced on 21 July 1998, when the inquiry report was released, that he had directed officials to develop detailed proposals for disclosure of asset management plans.

23 Ensuring security of lines is a matter of legitimate public interest. The Ministry considers that disclosure of asset management plans will help promote strong incentives to put in place and maintain good practices within New Zealand, and will assist companies in demonstrating that they follow high standards.

24 Disclosure is expected to enhance the quality of discussion between line businesses and those parties who have the ability and incentive to review the plans. This is consistent with the Government Policy Statement on line security published on 7 April 1998. More specifically, we expect that disclosed asset management plans will be reviewed by retailers (who have an interest in ensuring that final consumer needs are met) and by those consumers who have the expertise to interpret the plans (eg larger industrial and commercial consumers). A strong measure of peer review within the industry will also be possible following disclosure. The Ministry considers that each of these will help improve the reliability of line supply, consistent with consumer expectations.

25 With these considerations in mind, the Ministry asked PricewaterhouseCoopers to conduct preliminary work on the suggested requirements for disclosure of asset management plans for discussion with the industry and other interested parties. Annex 2 sets out the suggested requirements, based on the brief review performed by PricewaterhouseCoopers, but in summary it is proposed that asset management plans contain information on:

- the background and objectives of the plan (including relationships with other corporate goals, and accountabilities and responsibilities for asset management);
- the assets covered;
- proposed service levels;
- network development and lifecycle asset management action plans (including planning assumptions, demand forecasts and policies on non- asset solutions);

¹ For comments on planning issues, see for example finding 6 in section 7.4, findings 5 and 7 in section 8.4, and paragraph 17 in section 11.1.3 of “Auckland Power Supply Failure 1998, Report of the Ministerial Inquiry”.

- risk policies and mitigation; and
- performance measurement, evaluation and improvement.

It is also proposed that the plans be disclosed annually to parties making requests to see them and possibly on the Internet. The Ministry welcomes comment on these proposals.

Disclosure of reliability performance standards and targets

26 The Ministerial inquiry into the Auckland failure also recommended that line companies be required to disclose past and future security standards.

Past security standards

27 The Regulations already require line companies to disclose a comprehensive range of reliability, security and availability performance measures (the latter two broken down into interruption classes), and the Ministry is proposing the amendments outlined in paragraph 17 above for these.

Future security standards

28 The Ministry proposes that the Regulations be amended to require line companies to disclose, in addition to ex post information, details of the performance they plan to achieve in future. They would be required to disclose performance targets for:

- Maximum total number of interruptions;
- Maximum total number of faults per 100 circuit kilometres of line;
- System average interruption duration index (“SAIDI”);
- System average interruption frequency index (“SAIFI”); and
- Customer average interruption duration index (“CAIDI”).

broken down (except in the case of faults per 100 kms) into:

- planned interruptions by the line company; and
- unplanned interruptions originating within the works of the line company;

and showing (for all five measures):

- the target for the coming year; and
- the average target for the coming five years.

² See recommendation 12 of the Report.

Disclosure of faults for lines of different voltages

29 The Inquiry also proposed that line companies be required to disclose past and future security standards for lines of different voltage. The Ministry proposes to amend the Regulations to require disclosure of faults per 100km in the same categories as used by ESANZ - that is, 110kV, 66kV/50kV, 33kV, 22kV, 11kV, 6.6kV and 3.3kV lines or cables. It is also proposed that line companies disclose future performance targets (coming year and average for the coming five years) for each of these categories.

PROPOSALS INTENDED TO MAKE DISCLOSED INFORMATION MORE ACCESSIBLE TO THE GENERAL PUBLIC

Disclosure of "user-friendly" summaries

30 In order to make disclosed information more accessible to the general public, the Ministry proposes that line companies be required to disclose "user-friendly" summaries of their disclosures (in addition to their full disclosures). This follows the Government announcement on 7 April 1998.

31 It is proposed that:

- A standard template for the "user friendly" summaries would be prepared by the Ministry (it is likely that the template would cover profits, costs and reliability).
- Companies would be required to complete the template, filling in the relevant figures from their own disclosures.
- The summary would also include data about the industry averages and ranges of figures for each measure. This data would be calculated by the Ministry of Commerce once all companies had made their annual disclosures and would be notified to the companies by the Ministry. The deadline for companies to disclose the summaries would be one month after the Ministry had notified companies of the average and range data.
- Companies would be required to:
 - i. publish the "user-friendly" summary in their local newspaper;
 - ii. make the summary available on request to any interested person (by making copies available at their offices or by posting them to people on request);
 - iii. publish the summary on the Internet; and
 - iv. provide copies of their summary to the Ministry of Commerce.

Public disclosure of ODV reports

32 Under Regulation 14A(1), line owners are required to make "valuation reports" available for inspection at their principal company office. In order to make disclosed

information more accessible to the general public, the Ministry proposes that the Regulations require that copies of the valuation reports be provided to any person requesting one, as with most other data.

33 This measure is considered desirable given the importance of ODV valuations, and will not increase compliance costs as the Electricity Act has been amended to allow for recovery of reasonable costs of supplying information.

PROPOSALS TO ENSURE REGULATIONS ARE CONSISTENT WITH GAAP AND TO IMPROVE DEFINITIONS FOR FINANCIAL PERFORMANCE MEASURES

Consistency of the financial statements with GAAP

34 The Ministry has reviewed its approach to the applicability of GAAP to the financial statements disclosed under the Regulations, and has concluded that these statements should be GAAP compliant. GAAP is the authoritative set of rules for accounting purposes in New Zealand, and it seems sensible to base the regulatory accounts on this firm foundation.

35 The earlier proposal that conflicts between GAAP and the Regulations with respect to the financial statements should be resolved in favour of the Regulations (ie the Regulations would take precedence), has accordingly been dropped. The Electricity Act 1992 requires that the disclosed financial statements comply with GAAP, and the Ministry does not propose to amend this requirement.

36 The revised approach will have the following implications:

- The present requirement that financial statements include only (i) the profit and loss statement and balance sheet (including notes to the statement and balance sheet), and (ii) a statement of accounting policies, would be extended so that cash flow statements and statements of movements in equity would need to be disclosed. The Ministry understands that the additional compliance costs will be minimal.
- The form that accompanies the statements (and, for consistency, the form that accompanies the performance measures) would be extended to describe:
 - i. The work done by the auditor;
 - ii. The scope and limitations of the audit;
 - iii. The existence of any relationship (other than that of auditor) which the auditor has with, or any interests which the auditor has in, the electricity company;
 - iv. Whether the auditor has obtained all information and explanations that he or she has required;
 - v. Whether, in the auditor's opinion, as far as appears from an examination of them, proper accounting records have been kept by the electricity company; and
 - vi. Whether, in the auditor's opinion, the financial statements comply with the financial reporting requirements of the Regulations, and if they do not, the respects in which they fail to comply.

- Under recently agreed policy, auditors were to attest that the accounts have been prepared in accordance with the Regulations, rather than requiring that they provide a true and fair view and have been prepared in accordance with the Regulations. In view of the proposal above that the financial statements be GAAP compliant, the Ministry proposes to re-insert the true and fair view wording in the form signed by auditors (Form 1 of the Regulations).
- Certain other information not provided for in GAAP would be required in the disclosed accounts (eg the requirement for disclosure of minimum line items).
- Harmonisation with GAAP would be introduced in relation to areas covered by both GAAP and the Regulations (eg terminology such as “financial report”, “statement of financial performance”, “statement of financial position”, and definitions such as “depreciation” and “subsidiary”).

37 The following points might also be noted:

- Application of ACAM will define the entity for disclosure reporting.
- The definitions and other requirements relating to disclosure of performance measures are set out in the First Schedule of the Regulations. A requirement to follow GAAP in relation to the financial reports does not mean that the requirements in the First Schedule need to follow GAAP.

Financial performance measures: amending the definition of EBIT to eliminate any amortisation of goodwill

38 The Ministry has considered the treatment of goodwill in the accounts of line businesses. Under the Regulations, goodwill is eliminated from the asset base for determining the profitability performance measures. If goodwill was not eliminated from the accounts of line businesses, the constraint that ODVs place on the value of line businesses could be undermined. This would allow line businesses to hide ARPs in excess of WACC.

39 An additional issue that has come to our attention is that goodwill can be amortised over time, thus reducing EBIT and the profitability performance measures. This also has the effect of undermining the constraint that ODVs place on line businesses’ values. Purchase prices above ODV-based values can be recovered without showing up in ARPs that exceed WACC.

40 The Ministry recognises that there are circumstances which justify line businesses being purchased at prices above their ODV-based value. An example is where the purchaser is able to increase the efficiency of the line business, and decrease the line charges. It is reasonable for such purchasers to be “rewarded” by higher rates of return (including ARPs that exceed WACC). These rewards should be transparent so that they can be scrutinised by consumers and other interested parties.

41 Accordingly, the Ministry proposes to amend the definitions that apply to the performance measures in the First Schedule to ensure that any amortisation of goodwill is eliminated.

Energy Markets Policy Group
Resources & Networks Branch
Ministry of Commerce
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[DRAFT]

Accounting Separation and Allocation Handbook for Electricity Line and Supply Businesses

Energy Markets Policy Group
Resources & Networks Branch
Ministry of Commerce
Wellington

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[date]

1 Preface

1.1 This Handbook sets out the business accounting separation and allocation methodology to be adopted by electricity companies in meeting the requirements of the Electricity (Information Disclosure) Regulations 1994.

1.2 This Handbook replaces the Handbook for the 1998/99 financial year, and is required to be applied from 1999/2000 onwards. The 1998/99 Handbook has been replaced to make the business accounting separation and allocation methodology compatible with the requirement for electricity companies to ownership separate their line and supply businesses, under the Electricity Industry Reform Act 1998.

1.3 The Handbook includes:

- a mandatory avoidable cost allocation methodology (ACAM) for allocating items amongst companies' business activities for disclosure purposes; and
- a list of items that companies' are required to separately disclose in their financial statements.

1.4 These requirements are intended to provide a consistent and robust basis for assessing whether:

- natural monopoly line businesses are earning excessive profits and/or incurring excessive costs; and
- there are cross-subsidies from the line to the contestable supply businesses of unseparated electricity businesses.

Energy Markets Policy Group
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Ministry of Commerce
Wellington

xx xx 1998

2 Business accounting separation and allocation methodology

Requirements of the Electricity (Information Disclosure) Regulations

2.1 Regulation 6 of the Electricity (Information Disclosure) Regulations 1994 requires:

- Line companies to provide separate audited financial statements, for their *line business*, that is, conveyance of electricity, ownership of works for conveyance of electricity and provision of line function services (see paragraphs 2.2 to 2.7).
- Electricity supply companies, that are owned by settling or mirror trusts or where corporate separation pending full ownership separation had been adopted, to provide separate audited financial statements for their *electricity supply business*, that is, the generation and retailing of electricity (see paragraphs 2.8 to 2.12).
- Electricity line and supply companies to prepare these financial statements on the basis of the business accounting separation and allocation methodology specified in this Chapter.
- Financial statements for electricity line and supply companies' "other" activities are not required to be disclosed (such activities are labeled "other" in this Chapter).

Avoidable cost allocation methodology for line businesses

2.2 *The avoidable cost allocation methodology (ACAM) defines the line business as the "stand-alone" business and makes an assessment of the costs, revenues, assets and liabilities ("items") that would be avoided by the line company if it did not operate its "incremental" ("other") businesses. The components of the items that would not be avoided are allocated to the line business, and the components that would be avoided are allocated to the "other" business.*

2.3 It is *mandatory* for line companies to apply ACAM in preparing the separate financial statements for their line businesses. *ACAM consists of two mandatory principles:*

Principle I

2.4 The line and "other" businesses are to be defined in such a way that:

- a) the line business is confined solely to provision of natural monopoly electricity activities³;
- b) all contestable (and potentially contestable) activities are provided by the "other" business.

³ **Natural monopoly activities are activities which can be provided at a lower cost if they are provided by only one business, rather than two or more businesses.**

Explanatory note: Defining the line and “other” businesses in this way may mean they provide each other with goods and services. Transfer payments are made for any goods and services the line and “other” businesses provide each other (refer to Regulation 20).

Principle II

2.5 The costs, revenues, assets, and liabilities (“items”) are allocated to the line and “other” businesses in such a way that⁴:

- a) Those items (and components of the items) that would not be avoided if the line company did not operate the “other” business are allocated to the line business; and
- b) Those items (and components of the items) that would be avoided are allocated to the “other” business.

Explanatory note: Items that are directly attributable to one of the line or “other” businesses are allocated to that business. Items that are shared by the line and “other” businesses are allocated amongst those businesses, by:

- i. *direct allocation of any components of these items which are directly attributable to one of the businesses; and*
- ii. *for any components that are not directly attributable:*
 - a) *assessing the proportions of these components which are avoidable and non-avoidable; and*
 - b) *allocating these components amongst the businesses on the basis of those proportions (in a manner consistent with Principle I).*

Exemption

2.6 If “other” activities account in aggregate for less than 5% of the line company’s total assets and revenues, these may be accounted for in the line business or separately.

Explanatory note: Inclusion of “other” activities in these circumstances will have an insignificant impact on line business stand-alone financial statements.

Allocation of specified items

2.7 Table I specifies a list of items (which is not exhaustive) to be allocated amongst the line and “other” businesses. The table is to be interpreted in the following manner:

⁴ Conceptually there are two approaches to ACAM: (a) a "bottom-up" approach which asks what would the line company’s financial statements look like if it only provided line services; and (b) a "top-down" approach which asks what the electricity company's financial statements would like if it ceased operating “other” services (assuming away transitional factors, such as redundancy costs and down-sizing of fixed assets). With the bracketed assumption in (b), the bottom-up and top-down approaches should provide identical financial statements.

Rule (i) It is *mandatory* to allocate the *specified items* only to the line or “other” business if there is a tick in the relevant column (the columns labeled “LB” and “Other”).

Explanatory note: Where only one column is ticked, the item is to be entirely allocated to that business. For specified items this requirement will satisfy ACAM.

Rule (ii) It is *mandatory* to individually disclose those items for which there is a “Yes” in the column labeled “To be separately identified in financial statements?”.

Explanatory note: Although items marked “no” are not required to be separately disclosed, companies may do so if they wish.

Avoidable cost allocation methodology for electricity supply businesses

2.8 It is *mandatory* for electricity supply companies to apply the avoidable cost allocation methodology (ACAM) in preparing the separate financial statements for their electricity supply businesses.

2.9 ACAM defines the electricity supply business as the “incremental” business, and “other” as the “stand-alone” business. ACAM makes an assessment of the costs, revenues, assets and liabilities (“items”) that would be avoided by the electricity supply company if it did not operate its “incremental” business. The components of the items that would be avoided are allocated to the electricity supply business, and the components that would not be avoided are allocated to the “other” business.

2.10 The costs, revenues, assets, and liabilities (“items”) are allocated to the electricity supply and “other” businesses in such a way that:

- a) Those items (and components of the items) that would not be avoided if the electricity supply company did not operate the electricity supply business are allocated to the other business; and
- b) Those items (and components of the items) that would be avoided are allocated to the “electricity supply” business.

Explanatory note: Items that are directly attributable to one of the electricity supply or “other” businesses are allocated to that business. Items that are shared by the electricity supply and “other” businesses are allocated amongst those businesses, by:

- i. *direct allocation of any components of these items which are directly attributable to one of the businesses; and*
- ii. *for any components that are not directly attributable:*
 - a) *assessing the proportions of these components which are avoidable and non-avoidable; and*
 - b) *allocating these components amongst the businesses on the basis of those proportions (in a manner consistent with Principle I).*

Exemption

2.11 If “other” activities account in aggregate for less than 5% of the electricity supply company’s total assets and revenues, these may be accounted for in the electricity supply business or separately.

Explanatory note: Inclusion of “other” activities in these circumstances will have an insignificant impact on electricity supply business incremental financial statements. If the electricity supply business is not involved in other activities the “stand-alone” and “incremental” electricity supply business financial statements will be equivalent.

Allocation of specified items

2.12 Table 2 specifies a list of items (which is not exhaustive) to be allocated amongst the electricity supply and “other” businesses. The table is to be interpreted in the following manner:

Rule (i) It is *mandatory* to allocate the *specified items* only to the electricity supply or “other” business if there is a tick in the relevant column (the columns labelled “ESB ” and “Other”).

Explanatory note: Where only one column is ticked, the item is to be entirely allocated to that business. For specified items this requirement will satisfy ACAM.

Rule (ii) It is *mandatory* to individually disclose those items for which there is a “Yes” in the column labeled “To be separately identified in financial statements?”

Explanatory note: Although items marked “no” are not required to be disclosed, companies may do so if they wish.

TABLE 1: ALLOCATION OF SPECIFIC ITEMS

Item	To be separately identified in the line business financial statements?	LB ⁵	Other
<u>Current assets:</u>			
Bank, cash, short-term investments	Yes	✓	✓
Trade debtors	Yes	✓	✓
Other debtors	Yes	✓	✓
Inventory/stock	No	✓	✓
Work in progress	No	✓	✓
Prepayments	Yes	✓	✓
Total current assets	Yes	✓	✓
<u>Fixed assets:</u>			
Distribution system fixed assets	Yes	✓	
Centralised load control equipment	Yes	✓	
Meters and customer-based load control equipment	No		✓
Generation plant ⁶	No		✓
Own generation transmission and connection assets ⁷	No		✓
Capital works in progress	No	✓	✓
Customer billing and information assets	Yes	✓	✓
Motor vehicles	Yes	✓	✓
Office equipment	Yes	✓	✓
Land and buildings	Yes	✓	✓
Total fixed assets	Yes	✓	✓
Intangible assets	No		✓
Long-term investments	No		✓
Total assets	Yes	✓	✓
<u>Current liabilities:</u>			
Accounts payable	Yes	✓	✓
Accrued payroll	Yes	✓	✓
Other accruals	Yes	✓	✓
Dividend provision	Yes	✓	✓
Provision for deferred maintenance	Yes	✓	✓
Total current liabilities		✓	✓
<u>Funding:</u>			
Long-term debt	Yes	✓	✓
Shareholders' funds	Yes	✓	✓
Total equity and liabilities	Yes	✓	✓
<u>Revenue:</u>			
Revenue from electricity sales	No		✓
Revenue from line charges:			
- Line/access charges	Yes	✓	
Payments from ESB for metering data (transfer payment)	No		✓
Payments from LB for avoided transmission costs (transfer payment)	Yes		
Appliance sales	No		✓

⁵ Items ticked in the "LB" column may be allocated to companies' line business financial statements.

⁶ The Electricity Industry Reform Act permits line companies to own generation plants with a name plate capacity of up to 5MW (in aggregate) if owned prior to 23 June 1998, and to sell and generate up to 2.5GWh per annum.

⁷ Connection and transmission assets relating to a company's own generation plant are to be allocated to the "other" business. Where the company owns connection/transmission assets relating to another company's generation plant, these should be allocated to the line business.

Item	To be separately identified in the line business financial statements?	LB ⁵	Other
Temporary supply sales	No	✓	
Disconnection/reconnection income	No	✓	✓
Payments from Retailers for provision of reconciliation services (transfer payment)	Yes	✓	
AC rental rebates	No	✓	
Rental income	No		✓
Income from interest on short-term investments	Yes	✓	✓
Income from interest on long-term investments	No		✓
Dividend income	No		✓
Gain (loss) on investments	No		✓
Total revenue	Yes	✓	✓
<u>Expenditure:</u>			
Payment for transmission charges	Yes	✓	
Payment to Other for metering data (transfer payment)	Yes	✓	
Payment to Other for customer-based load control (transfer payment)	Yes	✓	
Payment to Other for avoided transmission costs (transfer payment)	Yes	✓	
Cost of appliance sales	No		✓
Payment to "other" for asset construction and maintenance, meter reading, disconnections/reconnections (transfer payments)	Yes	✓	
Payment to external contractors for asset construction and maintenance, meter reading, disconnections/reconnections	Yes	✓	
Generation maintenance	No		✓
Employee salaries and redundancies	Yes	✓	✓
Customer billing and information expense	Yes	✓	✓
<u>Depreciation on:</u>	Total		
- Distribution system fixed assets	depreciation	✓	
- Centralised load control equipment	expense to be	✓	
- Customer-based load control	separately		✓
- Meters	identified		✓
- Capital works in progress		✓	✓
- Generation plant			✓
- Generation transmission lines			✓
- Customer billing and information assets		✓	✓
- Motor vehicles		✓	✓
- Office equipment		✓	✓
- Buildings		✓	✓
- Other assets			✓
<u>Corporate and administration:</u>	Total		
- Telephone, fax, cafeteria	corporate and administration	✓	✓
- Insurance and security	expense to be	✓	✓
- Accounting, treasury, auditing, bank fees, directors' fees, trust fees and expenses, donations, photocopying, subscriptions, and any other corporate and administration expenses	separately identified	✓	✓
Motor vehicle expenses	No	✓	✓
Office equipment maintenance	No	✓	✓
Land and building expenses	No	✓	✓
Human resource expenditure	Total human resource	✓	✓
- FBT	expenditure to be		
- ACC	separately identified		
- Superannuation			
- Training			
- Recruitment			
Marketing/advertising	Yes	✓	✓

Item	To be separately identified in the line business financial statements?	LB ⁵	Other
Energy trading expenses	No		
Bad debts and collection costs	No	✓	✓
Merger and acquisition costs	Yes	✓	✓
Takeover defence costs	Yes	✓	✓
Research and development	Yes	✓	✓
Consultancy and legal expenses	Yes	✓	✓
Total expenditure	Yes	✓	✓
Earnings before interest and tax	Yes	✓	✓
Interest expense	Yes	✓	✓
Taxation expense	Yes	✓	✓
Net profit after tax	Yes	✓	✓
<u>Other</u>			
Financial hedges for risks relating to the price of electricity in New Zealand ⁸			✓

⁸ Depending on the circumstances and the treatment of financial hedges in the financial statements, these may be classified as assets, liabilities, expenses and/or revenue items (they might also include costs arising from guarantees relating to performance under hedges).

TABLE 2: ALLOCATION OF SPECIFIC ITEMS

Item	To be separately identified in the supply business financial statements?	ESB ⁹	Other
Current assets:			
Bank, cash, short-term investments	Yes	✓	✓
Trade debtors	Yes	✓	✓
Other debtors	Yes	✓	✓
Inventory/stock	No	✓	✓
Work in progress	No	✓	✓
Prepayments	Yes	✓	✓
Total current assets	Yes	✓	✓
Fixed assets:			
Meters and customer-based load control equipment	Yes	✓	
Generation plant	Yes	✓	
Own generation transmission add connection assets	No	✓	
Capital works in progress	No	✓	✓
Customer billing and information assets	Yes	✓	✓
Motor vehicles	Yes	✓	✓
Office equipment	Yes	✓	✓
Land and buildings	Yes	✓	✓
Total fixed assets	Yes	✓	✓
Intangible assets	No	✓	✓
Long-term investments	No		✓
Total assets	Yes	✓	✓
Current liabilities:			
Accounts payable	Yes	✓	✓
Accrued payroll	Yes	✓	✓
Other accruals	Yes	✓	✓
Dividend provision	Yes	✓	✓
Provision for deferred maintenance	Yes	✓	✓
Total current liabilities	Yes	✓	✓
Funding:			
Long-term debt	Yes	✓	✓
Shareholders' funds	Yes	✓	✓
Total equity and liabilities	Yes	✓	✓
Revenue:			
Revenue from electricity sales to final customers ¹⁰	Yes	✓	
GB revenue from external parties	Yes	✓	
Payments from LB for metering data (transfer payment)	Yes	✓	
Payments from LB for customer-based load control (transfer payment)	Yes	✓	
Payments from LB for avoided transmission costs (transfer payment)	Yes		
Appliance sales	No		✓
Temporary supply sales	No	✓	
Disconnection/reconnection income	No	✓	
AC rental rebates	No	✓	
Rental income	No		✓

⁹ Items ticked in the "ESB" column may be allocated to companies' electricity supply business financial statements.

¹⁰ This will include revenue recovering both electricity retailing costs and line charges (where line charges are passed on to the ERB by the LB, for collection from final customers).

Item	To be separately identified in the supply business financial statements?	ESB ⁹	Other
Income from interest on short-term investments	Yes	✓	✓
Income from interest on long-term investments	No		✓
Dividend income	No		✓
Gain (loss) on investments	No		✓
Total revenue	Yes	✓	✓
<u>Expenditure:</u>			
Purchases of wholesale electricity (external)	Yes	✓	
Purchases of wholesale electricity from own GB (transfer payment)	Yes	✓	
Payment to LB with which ERB is in PBR for line/access charges (transfer payment)	Yes	✓	
Payment to other LBs for line/access charges	Yes	✓	
Payment to LB for centralised load control (transfer payment)	Yes	✓	
Payments to LB for provision of reconciliation services (transfer payment)	Yes	✓	
Cost of appliance sales	No		✓
Payment to "other" for asset construction and maintenance, meter reading, disconnections/reconnections (transfer payments)	Yes	✓	
Payment to external contractors for asset construction and maintenance, meter reading, disconnections/reconnections	Yes	✓	
Generation maintenance	No	✓	
Employee salaries and redundancies	Yes	✓	✓
Customer billing and information expense	Yes	✓	✓
<u>Depreciation on:</u>	Total depreciation is		
- Customer-based load control	to be separately	✓	
- Meters	identified	✓	
- Capital works in progress		✓	
- Generation plant		✓	
- Customer billing and information assets		✓	✓
- Motor vehicles		✓	✓
- Office equipment		✓	✓
- Buildings		✓	✓
- Other assets			✓
<u>Corporate and administration:</u>	Total corporate and administration expense to be		
- Telephone, fax, cafeteria	separately identified	✓	✓
- Insurance and security		✓	✓
- Accounting, treasury, auditing, bank fees, directors' fees, trust fees and expenses, donations, photocopying, subscriptions, and any other corporate and administration expenses		✓	✓
Motor vehicle expenses	No	✓	✓
Office equipment maintenance	No	✓	✓
Land and building expenses	No	✓	✓
Human resource expenditure	Total human resource expenditure to be	✓	✓
- FBT	separately identified		
- ACC			
- Superannuation			
- Training			
- Recruitment			
Marketing/advertising	Yes	✓	✓
Energy trading expenses	No	✓	
Bad debts and collection costs	No	✓	✓
Merger and acquisition costs	Yes	✓	✓
Takeover defence costs	Yes	✓	✓

Item	To be separately identified in the supply business financial statements?	ESB ⁹	Other
Research and development	Yes	✓	✓
Consultancy and legal expenses	Yes	✓	✓
Total expenditure	Yes	✓	✓
Earnings before interest and tax	Yes	✓	✓
Interest expense	Yes	✓	✓
Taxation expense	Yes	✓	✓
Net profit after tax	Yes	✓	✓
<u>Other</u>			
Financial hedges for risks relating to the price of electricity in New Zealand ¹¹	Yes	✓	

¹¹ Depending on the circumstances and the treatment of financial hedges in the financial statements these may be classified as assets, liabilities, expenses and/or revenue items.

ANNEX 2 : LINES BUSINESS ASSET MANAGEMENT DISCLOSURE – SUGGESTED REQUIREMENTS

CORE ELEMENTS OF ASSET MANAGEMENT

A large number of models and approaches exist to the development of AMPs. Examination of comprehensive asset management definitions and models reveal the following common best practice features:

- Driven by business objectives and service level targets
- Encourage the use of “non-asset” solutions and demand management techniques as alternatives to asset acquisition
- Emphasis on knowing what you own and why, where it is, and what condition it is in
- Emphasis on optimising asset utilisation and performance

- Take a total life-cycle approach
- Focus on performance measurement, monitoring and continuous improvement
- Clearly assign accountabilities and responsibilities for asset management

Activities such as detailed quantitative risk analysis, optimisation of renewals and predictive modelling are often termed advanced asset management techniques, and are beyond the definition of core asset management.

CRITERIA FOR SUGGESTED DISCLOSURE REQUIREMENTS

The following criteria underpin the selection of the suggested information disclosure requirements:

- 1) Explicit support of service level objectives
- 2) Based on ‘core elements’ of asset management
- 3) Economically justifiable with minimum compliance costs, consistent with criteria 1) and 2)

To ensure unambiguous and consistent definitions of asset management planning, promote best practice, and maximise comparability, disclosure should focus on the ‘core elements’ of asset management, as defined above.

AMP information disclosure should be sufficient to provide assurance of the suitability of network assets for future and current service targets, and that AMPs provide a sound basis for the ongoing assessment of asset related risk.

DISCLOSURE REQUIREMENTS - INTRODUCTION

AMP disclosure will require line companies to:

- 1) disclose their most recent asset management plan, by:
 - (a) making it available for public inspection, during ordinary office hours, at their principal office
 - (b) post copies of the plan to people requesting it
 - (c) [disclose the plan on the Internet]

- 2) disclose asset management plans:
 - (a) each year
 - (b) that include a summary
 - (c) that consist of a single document
 - (d) that are able to -
 - i. permit assessment of the suitability of asset management practice and assets for current and future service,
 - ii. specifically support the achievement of disclosed reliability performance targets, and
 - iii. form a sound basis for on-going risk assessment

COMMENTS

AMPs vary in length but should be expected to contain reasonably detailed information and analysis if they are to be meaningful.

[Internet disclosure of the plans requires clarification of format and website placement.]

- (a) AMPs will be revised yearly to support annual performance measure disclosures and performance assessment. AMPs are dynamic documents that are normally updated annually.
- (b) Inclusion of summaries will aid understanding and readability. Minimum requirements for summaries are indicated below.
- (c) Disclosure of plans as a single document will prevent disclosure of disjointed, poorly co-ordinated AMPs that are difficult to understand and read. In some cases this will require companies to amalgamate disparate documents for disclosure purposes, for example, separate network development plans. This does not necessarily require integration of separate plans into a new framework if the linkages between parts of the plan are made apparent and indexed.
- (d) This requirement has been included to ensure the over-riding intention of disclosure is explicit, and emphasise that suggested disclosure information is compiled with these primary criteria firmly in mind.

DISCLOSURE REQUIREMENTS - INTRODUCTION

- 3) include statements which clearly identify limitations in availability or completeness of asset information, and include details of:
- (a) the assumptions made and basis for asset management planning in the absence of such information, including estimation and assessment methodologies used, and
 - (b) plans for improvement in information quality

COMMENTS

The detail and accuracy of information available will vary. Identification of information gaps should be specifically addressed by requiring disclosure for AMP purposes.

This will assist in transparency of disclosure, place emphasis on identification of deficiencies and promote improvement.

Compliance costs will be incremental, as information for asset management purposes is progressively improved and collected. This is realistic given the cost of data gathering exercises.

DISCLOSURE REQUIREMENTS - SUGGESTED DETAILS***COMMENTS*****Content of Summary**

A summary of the asset management plan is to be included which provides a brief overview of:

- purpose of the plan
- asset management systems and information
- network and asset description
- service level objectives
- lifecycle asset management and development plans
- risk assessment
- performance and plans for improvement

Details of AMP background and objectives, including:

- Interaction with other corporate goals, business planning processes and other plans
- Planning periods adopted
- Stakeholder interests (owners, customers, etc)
- Accountabilities and responsibilities for asset management
- Details of asset management systems and processes including asset management information systems/software and information flows

An outline of how the AMP is structured, together with links and relationships with business, financial, human resource, business continuance, information systems and other plans will reconcile corporate objectives with asset management objectives, put the detailed provisions in context and reveal overall approach. Skills and resources must be available to support the asset management strategy, and the organisation and identification of personnel accountability supports this. The way in which information systems support asset management processes should be disclosed.

DISCLOSURE REQUIREMENTS - SUGGESTED DETAILS

Details of assets covered, including:

- - Description of the asset configuration
- Identification of assets by category
- Justification for asset
- Location, age and condition

Details of proposed levels of service, including:

- Customer oriented reliability, security and availability performance targets
- Other targets relating to asset performance, asset efficiency, and effectiveness and efficiency of line company activity
- Justification for target levels of service based on customer, legislative, regulatory, shareholder and other requirements

Details of network development and lifecycle asset management plans, including:

- Description of planning criteria and assumptions
- Details of demand forecasts, network configuration analysis, and reliability assessments
- Policies on non-asset solutions, redeployment and upgrade of existing assets, acquisition of new assets, adoption of new technology and disposal of existing assets
- Analysis of the options available and details of the decisions made to satisfy and meet target levels of service

COMMENTS

What is owned and why, where it is and what condition it is in.

The asset management process is based on the identification of the business need for the use of the assets. For the purposes of information disclosure it is appropriate to concentrate on customer related performance measures, although the AMP should also state other commonly used efficiency measures for assessing company asset management performance.

Most companies have documented service levels and inclusion in the disclosure regime should not be onerous, although they will require careful consideration and definition by each company.

These requirements will form the largest part of the AMP, and will generally be subject to the largest variation in format and content between companies. These requirements are intended to be sufficiently non-prescriptive to avoid compliance costs associated with revision of existing plans.

Adoption of asset management practice that is cognisant of all elements of the asset life cycle, including design and planning, procurement, operation and maintenance and disposal costs will assist in long term efficiency improvement.

DISCLOSURE REQUIREMENTS - SUGGESTED DETAILS

- Description and identification of maintenance policies, programme and actions to be taken for each asset group
- Description and identification of the network development programme and actions to be taken

Details of risk policies, assessment and mitigation, including:

- Methods, details and conclusions of risk analysis
- Details of emergency response and contingency plans

Details of performance measurement, evaluation and improvement, including:

- Review of progress against plan
- Evaluation and comparison of actual performance against targeted performance objectives
- Gap analysis and identification of improvement initiatives

COMMENTS

Maintenance policies and strategies require to specifically address the needs of individual asset groups. Disclosure requirements will reveal whether appropriate steps have been taken to ensure that predictive, failure finding or scheduled maintenance tasks have been identified and are being undertaken.