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14 November 2008

Levy Regulations Review
Part 4 of the Commerce Act
Energy and Communications Branch
Ministry of Economic Development
PO Box 1473
WELLINGTON

Dear Sir/Madam

Submission on Funding the Regulation of Electricity, Gas and Airports Sectors Discussion Paper

A revised regulatory regime for electricity lines businesses ("ELBs"), gas pipeline businesses ("GPBs") and major international airports will come into effect on 1 April 2009 via a new Part 4 of the Commerce Act 1986 ("the Act"). Section 53ZE of the Act will provide for levy regulations to recover the costs of the Commerce Commission ("the Commission") in respect of its role in the regulation for these sectors. Levy regulations currently exist for ELBs and the controlled businesses of GPBs. These regulations require amendment, and new regulations are required for the airports sector as a result of the changes to the Act.

Accordingly, the Ministry of Economic Development ("MED") has released a Discussion Paper on levy options: *Funding the Regulation of Electricity, Gas and Airports Sectors under the revised Commerce Act 1986, Discussion Paper, October 2008*.

This letter forms our submission on the Discussion Paper which has been prepared by PricewaterhouseCoopers on behalf of the following 22 large ELBs:

- Alpine Energy Limited
- Aurora Energy Limited
- Buller Electricity Limited
- Counties Power Limited

- Eastland Network Limited
- Electra Limited
- Electricity Ashburton Limited
- Electricity Invercargill Limited
- Horizon Energy Distribution Limited
- MainPower New Zealand Limited
- Marlborough Lines Limited
- Nelson Electricity Limited
- Network Tasman Limited
- Network Waitaki Limited
- Northpower Limited
- OtagoNet Joint Venture
- Scanpower Limited
- The Lines Company
- The Power Company Limited
- Top Energy Limited
- Waipa Networks Limited
- Westpower Limited.

This group of Electricity Distribution Businesses ("EDBs") together comprises 572,510 connections (or 30% of the total electricity lines sector), and 69,847 system kilometres (47% of the total electricity lines sector).[1] The ownership structures represented include consumer and community trusts, a listed company, local body and co-operative ownership, as well as those managed by management companies. Group members include networks with predominantly urban systems, others that are sparsely populated and a number with significant urban areas combined with rural and remote rural characteristics.

Regulation of ELBs

1. ELBs previously subject to Part 4A of the Act, are now to be regulated as follows:

   - 100% consumer owned ELBs (which meet certain criteria) will only be subject to information disclosure regulation from 1 April 2009
   - All other ELBs will be subject to information disclosure and default/customised price/quality regulation.

[1] Based on 2007 Information Disclosure Data

2. In order to implement information disclosure and price/quality regulation, the Commission must develop and consult on key input methodologies. Input methodologies must also be developed for the regulation of GPBs and airports.[2]

3. The Commission has a number of projects it must undertake over the next three years in order to implement the requirements of the new Part 4 of the Act. For the purpose of the Discussion Paper the Commission has provided an estimated budget for this work including its ongoing monitoring and compliance roles. The budget for each sector is as follows:

Estimated Costs to be Recovered by Regulatory Levy

($000)	**2008/09**	**2009/10**	**2010/11**	**Total**
Electricity	7,100	3,400	3,400	**13,900**
Gas	2,900	1,600	1,600	**6,100**
Airports	1,300	800	400	**2,500**
Total	**11,300**	**5,800**	**5,400**	**22,500**

4. Within the electricity sector budget, allowance has been made for the following activities:

   - Input methodologies
   - Information disclosure
   - Residual administration of Part 4A
   - Default/customised price/quality regulation.

   An allocation of the budget between these activities has not been provided.

5. We note the significant level of cost which is included in the budget, and which is to be recovered from regulated businesses. We are concerned that there has been no explicit cost benefit analysis included in the Discussion Paper or in the consultation which led to the Part 4 reforms. We estimate that the proposed costs will equate to approximately $7 per connection for electricity consumers alone over the three years. For those that are also gas consumers and airport users, the direct costs of regulation will be greater. For this reason we encourage the Commission and the MED to ensure that the direct costs of regulation are minimised and that any potential synergies between the sectors are fully exploited to minimise the amount of duplicated effort and ultimately the total direct costs of regulation.

[2] Only Auckland, Wellington and Christchurch airports.

Questions for Consultation – Electricity Lines Businesses Design of Levy

6. The remainder of our comments included in this submission are relevant to the design of the regulatory levy for ELBs. We address the two key issues, how the levy is to be allocated between activities and how each activity cost is to be allocated between ELBs, by responding to the specific questions for submitters which are included in the Discussion Paper.

> 47. Do you consider that the proposed allocation of costs for different activities (only lines businesses subject to price-quality regulation pay for the costs of this part of the regime, all lines businesses pay for all other activities) is appropriate?
>
> 48. If not, what do you consider could be used as a method to allocate costs for different activities and why?

7. The Discussion Paper presents the following options for the allocation of the levy between activities:

   - Lines businesses subject to price/quality regulation contribute to the costs associated with this activity, all lines businesses contribute to the remaining costs
   - One levy for all activities
   - Separate levies for each activity
   - Lines businesses pay directly for costs based on activities and the time spent by the Commission.

   All of these options are also subject to section 53Y of the Act which provides for the business specific costs for customised price/quality regulation to be recovered from the business seeking customised terms.

8. Consistent with the Discussion Paper we support the first option, which separates out the costs of the default/customised price/quality regulation and shares these amongst those ELBs subject to this form of regulation. The costs of the remaining activities for the electricity sector (input methodologies, information disclosure and residual activities from the existing Part 4A) are shared between all ELBs. As input methodologies are interrelated with both information disclosure and price/quality regulation we believe it is reasonable for all ELBs to contribute to the cost of these. Attempts at further separation and more detailed allocation of the activities are likely to be complex, and potentially arbitrary. For this reason we do not support the option for the Commission to allocate its costs by the time spent on each activity, particularly as the activities are interrelated, and are not business specific. The Commission will as a minimum

need to allocate its activities between the three sectors, and for the electricity sector between default/customised regulation and the rest of the regulatory activity. This is sufficient and quite possibly challenging enough.

9. We note that Transpower is likely to require some business specific aspects to be incorporated into the regulations which affect them. We note however that as the overarching legislation is the same, the same regulatory principles will also apply to them. This will be reflected in the form of regulation (input methodologies, information disclosure and price/quality regulation) which will be the same form, with possibly slightly different implementation details to be developed for Transpower. We therefore support a common levy basis for Transpower and the EDBs. Later in this submission we highlight a number of implementation issues where common allocators may not exist for Transpower and the EDBs. If these implementation issues are unable to be resolved, we acknowledge that it may be necessary for the Commission to allocate its activity costs directly to Transpower, with the residual being allocated to the EDBs.

> 49. Do you consider that share of valuation (calculated using the methodology required by the Commerce Commission – currently ODV) is a reasonable basis to use to recover costs, within activities?
>
> 50. If you consider that an alternative basis would be better than share of total valuations of fixed assets, what would this be and why?

10. The Discussion Paper presents the following options for allocating the cost of regulatory activities between ELBs for the purpose of the regulatory levy:

    - Share of the total valuations of fixed assets using the Commission's valuation methodology, currently ODV
    - Number of customers served
    - The length (in kilometres) of networks
    - The total amount of electricity supplied over the network
    - A flat rate charge for each business being regulated
    - Costs allocated based on time spent by the Commission on the regulation of each business.

11. In principle we support using the valuation of the regulated assets to apportion the activity cost between ELBs as this best reflects the relative size of the regulated activities. In practice however the effective implementation of this option relies on the Commission mandating a

regulatory asset valuation approach which is common to all regulated ELBs, and which is made available on an annual basis in a timely manner.

12. In this respect, we note that currently:

- Transpower must, as part of its Deed of Undertaking with the Commission, value its electricity transmission system using a depreciated historical cost ("DHC") approach, based on a starting optimised deprival value ("ODV") value at 30 June 2006. This value is to be disclosed in its annual disclosures before the end of November each year (commencing in 2008).
- Electricity distributors must value their electricity distribution systems using the indexed historical cost ("IHC") approach in the years between periodic ODV valuations. These values are to be disclosed in annual disclosures before the end of August each year commencing in 2009 (with 2005 – 2008 values to be retrospectively disclosed before the end of February 2009). The Commission has signalled its intention to consult further on ODV, IHC or DHC options for EDBs and as a result this approach may change.

13. The immediate issue that this raises is that Transpower's value is unindexed from 2004 (as this is when the ODV rates were last set) and the EDB values are indexed from 2004 onwards, thus increasing their value relative to Transpower, all other things being equal.[3] Thus if this information was to be used to apportion the activity costs, EDBs would incur a disproportionately higher share of the costs than Transpower, due to the variance in the basis of valuation.

14. This may only be a short term issue. It is however dependent on the outcome of the forthcoming consultation on asset values as one of the key input methodologies. This is unlikely to be resolved until well into the three year period for which indicative regulatory costs have been provided. In the interim therefore we suggest:

- The 2007 ODV valuations, as disclosed in February 2008[4] for EDBs and November 2007 for Transpower are used to apportion the activity costs between ELBs
- Once the Commission's input methodology and information disclosure activities have been completed to a point where the regulatory asset valuation methodology

[3] A further divergence is that for 2005 and 2006, Transpower's additions are included at 2004 ODV values, but the EDBs' additions are included at cost, and indexed.
[4] 2007 Disclosures were delayed until February 2008 due to anticipated changes to the Disclosure Requirements, which were ultimately postponed into the following year.

is known further consideration of the appropriateness of the valuation approach should be made

- If consistent valuation approaches are required for all ELBs then asset values can continue to be used as activity cost allocators, once the asset valuations have been completed. If they are not, and there remains a difference between Transpower's regulatory valuation method and the valuation method for EDBs, then we suggest that the Commission separately identify the costs of each activity attributable to Transpower. Transpower's levy can then be derived accordingly, with the remainder to be apportioned between EDBs on the basis of relative valuation.

15. We do not support the use of the other allocators presented in the Discussion Paper. Using the number of customers served or the length of network lines and cables as allocators are inappropriate as relativities between ELBs are distorted by network characteristics, especially density. We also note that they cannot be applied consistently between Transpower and the EDBs. We also strongly oppose a flat rate levy because this leads to consumers of smaller ELBs contributing more than consumers of larger ELBs which is inequitable, particularly given the considerable divergence in size across the ELBs.

16. For the reasons outlined earlier we also believe that the option of allocating activity costs on the basis of time spent by the Commission on the regulation of each business is unworkable and likely to be arbitrary. Much of the Commission's work will apply to all ELBs, and therefore under this approach the Commission would still need to determine how to allocate shared costs.

17. If asset valuations become impractical due to ongoing divergence in valuation approach within the ELBs or unavailability of timely valuation information we would support the allocation of activity costs by the total amount of electricity supplied over the network, as the closest proxy to relative size of the regulated businesses. This is only practical however, if costs attributable to Transpower are allocated directly to them, before the remainder are shared between EDBs on the basis of energy supplied. It is not appropriate to include Transpower's electricity volume in this approach because of the duplication in volumes for the majority of Transpower's supply volume which is supplied to the EDBs.

18. We acknowledge the Discussion Paper's observation that ELBs have little influence on the volumes of electricity contracted, however ELBs essentially provide capacity and connections at locations which meet consumer demand. This demand is reflected in the volumes of energy that must be supplied and therefore in the absence of consistent asset values, this allocator provides the most relevant indicator of the relative size of the regulated businesses.

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51. Do you have any other comments regarding the design of levy regulation for electricity lines businesses?

19. In summary:

- We support the proposal to share the costs of developing input methodologies, information disclosure and the residual components of Part 4A between all ELBs, with the costs of default/customised regulation to be shared only amongst those to which it applies. We note that customised price/quality regulatory costs are to be borne by the ELB seeking customised terms.
- We support the allocation of activity costs between ELBs on the basis of asset valuation, only where consistent asset valuation approaches are used for all ELBs, and where timely valuation information is available.
- Until the valuation methodologies have been finalised, we suggest the 2007 Disclosures be used, as these include ODV values prepared using consistent rules for all ELBs.
- If once valuation methodologies have been finalised, there continues to be divergence in the approaches mandated by the Commission for regulatory purposes, we support using asset values to allocate costs between EDBs, after costs attributable to Transpower have been separately identified by the Commission.
- If consistent asset values for EDBs are not available, we support the use of electricity volumes supplied as the next best proxy of the relative size of the regulated businesses.

Levy Collection Arrangements

20. The Discussion Paper proposes that:

- Levies are collected quarterly, in equal instalments over the year
- The value is established at the beginning of the year, derived from estimated costs for the year
- Allocation between regulated businesses is undertaken using the relevant allocators that have been disclosed in the prior year
- At the end of the year, a reconciliation is undertaken to identify any over or under recovery, once actual regulatory costs are known and have been audited. Refunds or additional payments are to be made at that time.

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21. This approach is also proposed for GPBs and controlled airfields to ensure consistent application of the levy across all three sectors. We support a consistent approach.

22. We note that information disclosures for EDBs are required to be made available within 5 months after 31 March each year, by 31 August. We understand the financial year for the purposes of the levy commences on 1 July with the first quarter ending on 30 September. We therefore suggest that the amount of the levy is determined after disclosures have been made in August, with the first instalment invoiced at the end of the September quarter.

23. We note that currently gas pipeline disclosures, airport and Transpower's disclosures are made in November each year, which means they would not be available to suit this proposed timetable, and unless the timetable is changed, prior year information would need to be used.

General

If you have any queries in relation to this submission, please contact either of the signatories below.

Yours faithfully

Lynne Taylor	Craig Rice
Director	Partner
Advisory	Advisory