

Briefing note



7th September 2009

Commerce Commission Information Disclosure Discussion Paper - 29 July 2009

Purpose

The Commerce Commission has released a discussion paper setting out its preliminary views on an approach to information disclosure regulation under Part 4 of the Commerce Act 1986 (the Act). It seeks discussion on the application of information disclosure regulation which is relevant to suppliers of regulated electricity lines services.

This briefing paper provides advice to Major Electricity Users Group (MEUG) on the quality performance and asset management planning aspects of the proposed regulatory approach to information disclosure.

Why Asset Management Plans are important to customers

Asset management plans define the means by which business entities manage their infrastructure and asset bases and to what standards assets and infrastructure will be maintained. For electricity distribution business (EDB) owners and operators asset management plans are an effective tool for managing core business overheads, and allocating those costs to pricing formulas for services supplied to customers.

For electricity consumers asset management plans provide a window through which asset management targets, processes, and asset related performance can be viewed. A perspective on the levels of service and price quality trade off decisions can be gained. Larger electricity users have significant investments that rely on sound electricity infrastructure management. Major users may make new capital investment decisions on the basis of the promised and delivered levels of service from EDB assets, therefore, the asset management plan must be as transparent as possible.

Whilst the content of an asset management plan needs to be comprehensive it must be focused and structured in a way that makes information understandable and easily accessible to non technical readers. The asset management plan must also be a true representation of what the EDB actually does in practice. A plan that is produced solely for compliance with regulatory requirements would not be useful to electricity consumers and other stakeholders.

In order for consumers to engage effectively with electricity suppliers they need to be informed on the key aspects of electricity supply that relates to them. Asset management plans are an important tool for creating informed consumers.

What users need in a disclosed Asset Management Plan

To meet the needs of electricity consumers and network users disclosed asset management plans must, as a minimum, meet the following requirements:

a) Accuracy and reliability of asset and infrastructure management and forecast changes

Accuracy and reliability of the information provided in asset management plans is of primary importance to network users. Timeliness of information provision is also important and there is a case for some information to be published on an ongoing basis, for example monthly information on emerging trends are picked up quickly rather than wait for full asset management plan published the following April. The requirement for accuracy, reliability and timeliness of information, particularly applies to planned asset changes, and expansion of or reductions in service levels. Increasing service capacity in a region may provide development opportunities for businesses in that region. Decreasing or deteriorating service levels produce increased risks for consumers.

Asset management plans have a dual role to inform on the need for service and infrastructure changes and to report on the delivery of those asset and infrastructure changes.

b) Using a standardised approach and ensuring clarity of presentation

Requiring a standardised approach and format to be used for the content and structure of asset management plans will lead to greater clarity and consistency. Standardisation will also allow comparisons to be drawn between the approaches taken by different EDBs. This information may be useful to users when determining new locations for their operations and/or negotiating terms of connection. It may also be used as a benchmark to place pressure on EDBs to improve performance.

Fixing upon a particular Good Industry Practice asset management plan format or standard (such as the British PAS 55 standard) would help to identify differences between EDB asset management strategies and performance, and allow customers to make more informed choices. Currently, the Handbook can be considered to be defining 'Good Industry Practice' which is not the use that the Commission originally intended for it.

Over emphasis on a standardised approach can become too prescriptive and inhibit innovation and improvement. It has been observed that since the introduction for asset management plan disclosure, the size of these documents has grown considerably each year. A core of essential information should be

prescribed in a standard format with the EDB free to decide the format and quantity of other discretionary information. A summary of sources of other relevant information would be a valuable addition to asset management plans.

It is important that EDBs use appropriate Asset Management strategies (e.g. Reliability Centred Maintenance, condition monitoring and run to failure). Asset management plans provide a valuable source of information on how EDBs adopt and implement strategies. Different approaches taken by EDBs can be highlighted through comparison of approaches described in asset management plans. This information can identify performance issues and, possibly more importantly, successful and innovative approaches.

Standardisation of asset management plans must not be seen as requiring standardised asset management as this would reduce advantages from comparative assessment, competition between EDB management and innovation.

c) Term of asset management plans to be relevant to the assets and service level dynamics

The Commission has discussed using 10 years as the standard duration of asset management plans. It may be more relevant that this be broadened into more time frames relevant to the infrastructure and assets, and also tie in service level dynamics. EDB infrastructure and assets frequently have longer life spans than 10 years, and different organisations have different approaches for managing them. In practice, EDBs provide more detail on the two to five year plans than on the longer term and this should be considered to be appropriate.

Accordingly, it is considered that detailed asset management planning should be required for no more than five years from the present, and less detailed trend based views taken for infrastructure with longer life spans.

We would also like to see asset management plans define the strategies organisations apply to managing their longer lived infrastructure components and assets. This could include approaches like reliability centred maintenance, condition monitoring, and time based maintenance, and how individual entities manage classes of assets, and what combinations of approaches are applied to the organisation's total infrastructure and asset base.

d) Defining service in terms meaningful to interested parties

A key aspect of developing asset management plans for disclosure to interested parties is ensuring that the contents are meaningful to those interested parties. To meet this requirement, EDBs must change from supply based to service based thinking. This means looking at their service in the same terms as their consumers do. This implies that EDBs will consult their customers, or at least their largest customers, when developing asset management plans for disclosure.

Many EDBs survey customers with questions like "are you happy with the reliability of your supply?" and "would you pay more for a more reliable supply?." Most consumers have little information on which to base an answer, they have no

awareness of the state of the assets that supply them, for example. To a large extent, the types of customer survey currently undertaken by EDBs are of little value. To obtain real value, consumers must be informed and service level measures based on consumer requirements.

To achieve this, a standardised approach regulated by the Commission that produces meaningful service definitions and performance measures could provide a good foundation for developing informed consumers.

e) Cost/quality trade-offs and how asset management decisions are linked to price. How least cost solutions are determined and delivered

Asset management planning is a major driver of price formulation. From the point of view of users, the strategies encompassed by an asset management plan will dictate future supplier pricing as well as influence the quality of service received in the future.

For example, suppliers adopting a strategy of minimising infrastructure and maintenance of assets to the absolute minimum required to ensure supply, are able to pass their savings onto customers through lower prices. However, customers may also demand continuity of supply, and the maintenance of sufficient reserve capacity to assure supply even in the event of multiple component failure, and may be prepared to pay higher prices for that assurance. Accordingly, asset management strategies that maintain extra capacity, which translates to higher supply prices, may be preferred to those offering lower prices without assurance of supply.

In practice, the tradeoffs between costs and asset maintenance quality are more subtle and accordingly, it is important that asset management plans accurately illustrate the choices made by suppliers, but also the alternatives that might have been selected, and the reasons why they were not chosen. By taking this approach, suppliers would be able to assure their users that they have taken the best decisions possible under the applicable circumstances, and that their price structures, as well as their infrastructure and asset management strategies, are appropriate for their customers' needs.

Fixing upon a particular asset management plan format or standard (such as PAS 55) would help to identify differences between EDB asset management strategies and performance, and allow customers to make better informed choices in the future.

f) Capability of the EDB to deliver long term performance and service

Asset management plans are clearly an important measure of the overall capability of an EDB to deliver long term performance and the service demanded by customers. To that end, asset management plans must provide asset management performance information on a year to year basis. This will allow users to accurately assess the quality of the suppliers overall asset management

processes, and gauge the quality of future projections provided by the company through its statements of corporate intent. In this context, the asset management plan supports the annual reporting process.

Assessment of Commerce Commission proposal against User Requirements

Purpose and Definition of Asset Management Plans - Commission Definition

The Commission has defined asset management, in a broad sense, as the development and implementation of plans and processes, encompassing management, financial, consumer, engineering, information technology and other business inputs to:

- assess and record the nature, location, condition and performance of assets;
- develop and implement plans for the acquisition, creation, maintenance, operation, refurbishment, repair and disposal of its assets;
- ensure that the level of service provided to consumers through the use of its assets meets the supplier's internal targets, including those for requisite quality, and its regulatory and statutory obligations;
- minimise the risks associated with the failure or reduced performance of assets; and
- develop, test or simulate and implement contingency plans to deal with events which have a low probability of occurring, but are realistic and would have a substantial impact on consumers, in a way which minimises cost to consumers over the expected life cycle of assets.¹

The above is to be achieved "in a way which minimises cost to consumers over the expected life cycle of assets."²

It is considered that this approach is appropriate as it meets the classic definition and expectations of asset management plans. It is also noted that the Commission takes the view that disclosing asset management plans may generate reputational effects, strategic responses by suppliers, incentives for a regulated supplier to engage with its consumers, and prudence review of past investments.³ Again, these are outcomes which would benefit all consumers.

However, there may be unnecessary widening of the role of asset management plans over and above their normal role. Expanding the purpose of the asset management plan also increases the size of the document, and commensurably reduces the clarity of the asset management plan in terms of the ability of the user. Review of the information requirements should include an assessment of the core information that must be provided in a standard form and non essential information that the EBD is free to provide in a non standardised format.

¹ Commerce Commission, *Regulation of Electricity Lines Businesses Asset Management Plans: Revised Information Disclosure Requirements and Handbook Decision Paper*, 31 March 2006, paragraph 10.

² Information Disclosure Discussion Paper, 29 July 2009, Commerce Commission, paragraph 416.

³ Information Disclosure Discussion Paper, 29 July 2009, Commerce Commission, page 90

Responses to specific questions

Q.55) Do you agree that statistics information should include asset information, demand and capacity information? If not, please provide a reason for your view, an alternative and why you consider this to be preferable.

There would be benefits for consumers if EDBs provided statistical breakdowns of assets, demand, capacity, and pricing. These benefits would fall into business activities such as capacity planning and business development. Then comparative analysis can be undertaken on suppliers' core overheads.

It is possible that producing these outputs may create increased compliance costs for individual EDBs, particularly smaller entities not currently resourced to generate outputs at the level of sophistication a large customer may require. These compliance costs may be alleviated by enabling more effective self assessment and subsequent adoption of industry best practice, EDB collaboration on asset management components and other efficiency gains.

Q.56) Do you agree that suppliers of regulated services should apply a recognised asset management plan standard? If so, what is the appropriate standard that should be applied? Please provide the reasons why you consider it to be preferable?

There are benefits from adopting a recognised asset management plan standard. In the absence of suitable international alternatives, the BSI standard PAS 55 meets the basic needs of EDBs in that it provides a framework for assessing the professionalism of asset management plan preparation. It is noted that the PAS 55 assessment management certification program is designed to enable organisations to demonstrate robust asset management through a certification process, i.e. that it has a method of protecting and maximising benefits from its assets and investment.

This is quite different from the standard approach the Commission appears to be proposing as an effective way for users to measure the effectiveness of EDB asset management plans across the board. We also note that the Commission:

"...has no immediate plans to apply the standard under the information disclosure requirements, the standard may have relevance to information disclosure for regulated infrastructure industries, including gas, electricity and airports infrastructure. In the Commission's view the standard may be a useful tool for organisations seeking to demonstrate professionalism in managing their physical assets."⁴

While it appears that EDBs do possess the necessary professionalism in asset management, the outputs do vary in content and context, which is an issue for all consumers looking to improve their business position through evaluative comparisons between suppliers.

⁴ Ibid, page 91

The view could be taken that EDBs possess similar classes of assets, and therefore, a standard approach to disclosing asset management plans adopted by all the EDBs would be indeed advantageous to all consumers. This does not necessarily mean that all the asset management plans would use a standard format, but rather the mechanism for their disclosure would be standardised.

A key question that adoption of a standard like PAS 55 asks is how long it will take to establish PAS 55, or a suitable alternative, in New Zealand? As part of its regulatory development, should the Commission adopt a mandatory rather than voluntary asset management plan standard, there may be a need to be further work undertaken to establish an accredited certification programme through a suitable entity like JAS-ANZ and relevant NZ based certification agencies.

Q.57) Do you agree that asset management plans should cover at least a ten-year forecast period? If not, please provide a reason for your view, an alternative and why you consider this to be preferable.

It is considered that detailed asset management planning should be required for no more than five years from the present, and less detailed trend based views taken for infrastructure with longer life spans.

An alternative approach would be to base asset management plans on the management of asset groupings or classes rather than a specific time frame. The result would be separate asset management plan sections for individual asset classes or groupings which fall within time frame bands, or common asset management strategies. How an EDB allocates classes of assets into particular management strategies would be a useful indicator of the EDBs reading of future market needs, demands, and its likely area of business focus in the forecast periods.

Q.58) Do you agree that the asset management plans should be certified by directors that they are compliant with the requirements and that the asset management plan describes actual process and practices implemented by the business? If not, please provide a reason for your view, an alternative and why you consider this to be preferable.

There are two issues with this question. The first is the credibility of the asset management plan that it describes actual business processes and practices, and the second is how an asset management plan should be certified as actually doing so.

The credibility of the asset management plan is measured in two ways. The first measure is whether what the asset management plan describes is accurate in terms of content, process, and strategy, and the second is that the asset management plan has been produced in an approved manner, such as set out in the PAS 55 standard. Both can be managed through certification against a recognised bench mark or audit, either through independent certification or through self-certification.

Certification also relies on one of two basic approaches. The first is independent third parties, and the second is self-certification. The emphasis on both is ensuring that the certification process and outputs are credible.

Third party certification usually relies on an external assessment of the certifying body against an international standard by an independent accreditation agency, and that in turn may be subject to external assessment by an international accreditation body. This hierarchical approach provides a high level of assurance that certification offered by local certifying bodies is credible, especially if it is the result of assessment of the activities of the entity seeking the certification against an international standard.

Self-certification relies on the ability of an entity to provide credible assurance to interested parties that it meets a standard, code of compliance, or other agreed upon benchmark. In the case of company directors, we recognise that they have strong incentives to produce credible certification for asset management plans, or risk strong regulatory and corporate sanctions. EDBs directors would also be exposed to reputational risks if they were found to have failed to use sound self certification processes. Self-certification is most likely to be supported through independent auditing to provide the directors providing the certification with the assurance they need to perform the certification.

Our view is that the benefits of certification are real, and our preferred approach would be a robustly supported self-certification process.

Q.59) Do you agree that the Commission should review investment and innovation, quality and energy efficiency, demand side management and loss reductions as part of the asset management plan review process for Electricity Distribution Lines Businesses? If not, please provide a reason for your view, an alternative and why you consider this to be preferable.

The Commission's intention is to develop the existing asset management plan review to facilitate further the assessment of regulated suppliers. Whilst this new direction is appropriate improvement can be made to the scope of the additional review work required.

Whilst the Commission's intention to review investment and innovation is appropriate full cost benefit analyses should be undertaken as part of this process. EDBs have in the past provided energy efficiency programmes such as demand side management to customers but that leadership role has shifted to electricity retailers, specialist energy managers and EECA. Rather than funding energy efficiency programmes, EDBs have an influencing role with their customers, influencing change through efficient price signals.

Neither the Commission nor EDBs are currently well placed to promote energy efficiency amongst consumers. The Energy Efficiency and Conservation Authority and the Electricity Commission are far better placed to lead energy efficiency in the home and the workplace.

Reducing energy losses is an area in which line companies have a proper role in, but they lack the market incentives necessary to engage further. A good example is low

loss transformers. Installation of this type of transformer throughout the grid would significantly reduce transmission losses. However, investment in this technology is impeded by market price thresholds, which make the investment unprofitable. Instead, price thresholds perversely incentivise the installation of the older and cheaper transformer technology. Moreover, EDBs are remunerated for delivered power to local electricity retailers, not the power actually received by the customer. Local transmission losses are therefore met by the consumer, and the EDBs are not penalised for transmission losses.

It is noted that EECA is developing Minimum Performance Standards for 11 kV and 22 kV distribution transformers to improve the installation of low loss technologies. Also other regulatory interventions are in train that may overcome perceived market failures in this area.

EDBs should have an incentive to improve their network efficiency by, for example, reducing system losses. This is an important area not currently dealt with under the current regulatory framework.

Q.60) Do you agree that an asset management plan should include details of the background and overall approach to, and objectives of, a regulated supplier's asset management and planning processes? If not, please provide reasons for your view.

It is considered that the overall approach is appropriate. To ensure that interested persons are properly informed, the asset management plans need to have a clear structure with effective links within it to guide readers towards the information they need. The level of detail should not impair clarity.

Detailed descriptions of key asset management processes appears to be overkill in terms of the detail that interested parties will be expected to work through. Identifying service level arrangements for asset classes should be more than adequate for the needs of interested parties. Where greater detail is needed for individual customers, EDBs should be able to produce the information, but publishing it in an asset management plan is unnecessary.

While arguments can be made for including a great deal of material in an asset management plan, organisations produce other statutory reports, and in many cases, those reports are more appropriate for the material being discussed by the Commission under the banner of the asset management plan than the asset management plan actually is.

A simple reference that provides the sources of additional detailed information may be an effective way to reduce the volume and complexity of asset management plans.

Q.61) Do you agree that an asset management plan should include details of the assets covered by the plan? If not, please provide reasons for your view.

The descriptive level of asset coverage and detail proposed by the Commission is appropriate.

Q.62) Do you agree that an asset management plan should include details of the regulated suppliers' plans for asset growth and their methods for reaching asset - related growth decisions? If not, please provide reasons for your view.

The Commission's basic position on disclosure by regulated suppliers on decision-making for plans for asset management, asset growth, and how the decision-making process occurs is considered to be appropriate.

Q.63) Do you agree that an asset management plan should include details of the regulated suppliers plans for maintenance and renewal of assets over the planning period? If not, please provide reasons for your view.

The Commission's position that asset management plans should include plans for the maintenance and renewal of assets is appropriate as this is a core output from asset management plans. The degree of detail should be sufficient to meet the needs of interested persons, but not so great as to make it difficult for interested persons to understand the regulated supplier's asset management strategies.

Q.64) Do you agree that an asset management plan should include details of risk policies, assessment, analysis and mitigation methods, and details of emergency response and contingency plans? If not, please provide the reasons for your view.

The Commission's approach is supported. Risk management and mitigation are core components of an asset management plan. Accordingly, it is incumbent on regulated suppliers to disclose those details in their asset management plans. This is necessary so that the EDB can assure interested persons of its ability to manage and mitigate events affecting its asset base, and also assure customers of its ability to assure ongoing supply of services, and/or restore services should be they be affected by events.

Q.65) Do you agree that an asset management plan should include a regulated supplier's assessment of its performance against its own financial and service level targets as they relate to asset management planning? If not, please provide the reasons for your view.

The Commission's core objective of having regulated suppliers report against the financial and service level targets that result from asset management planning is appropriate. However, it is noted that annual reports are also a mechanism for this type of reporting, and that the Commission's aspiration may create overlaps in reporting responsibilities.

Nonetheless, there is likely to be considerable value in asset management plans reporting on the progress of regulated suppliers in implementing their previous asset management plans. Post-performance outcomes for expenditure, projects deferred

or cancelled, and projects rolled over etc. provide a wealth of data on the capability of a regulated supplier to predict, respond to, and meet the needs of customers.

Responses to related questions

Q.9) Do you agree that the disclosure of an asset management plan is an appropriate means of demonstrating innovation and investment? If not, please provide the reasons for your view, an alternative and why you consider this to be preferable.

The asset management plan is one of several vehicles for demonstrating innovation and investment. Other means of doing so are annual disclosures such as Statements of Corporate Intent, and Annual Reports. The issue for the Commission is whether interested persons are best served by the asset management plan as the sole source of innovation and investment disclosure by regulated suppliers, or are other mechanisms more appropriate for those disclosures?

Asset management plans are good for disclosing asset related innovation and investment decisions and forward planning relating to the network assets. Suppliers do other forms of innovation and investment, such as participating in research and development work, in many cases with R&D partners. That kind of development work is best described in SCI and Annual Reports. The results of such work may not appear in an asset management plan for some time, maybe never if the R&D proves unsuccessful or is superseded by other developments.

Q.50) Do you agree that requisite quality should be disclosed by suppliers of regulated services through the asset management plan so that they can choose the best way to establish and disclose the requisite level of quality? If not, please provide a reason for your view, an alternative and why you consider this to be preferable.

There are two issues here. The first is determining what measures and outputs will be used by the regulated supplier to determine quality. The second issue is where the outputs and outcomes should be reported.

Asset management plans are a viable way of selecting and disclosing measures, outputs, and outcomes for the management of an entity's assets. However, quality outputs apply across the full range of a regulated supplier's activities, and the asset management plan should relate to network asset performance measures and not unrelated areas, for example, where an organisation establishes systems for measuring the quality of corporate decision making or the quality of corporate business planning.

Some EDBs have published separate annual quality performance reports similar to those produced by Transpower. These separate reports can provide a more clearly presented and detailed source of relevant performance information than integrating them with asset management plans.

Q.71) Do you agree that the annual asset management plan and pricing methodology disclosures should be publicly disclosed? If not, please provide the reasons for your view, an alternative and why you consider this to be preferable.

The Commission's view that disclosures by regulated suppliers should be publicly available is supported.

Q.77) Do you agree that director certification should be required for the annual asset management plan and pricing methodology disclosures to certify that the information being disclosed complies with the relevant requirements? If not, please provide the reasons for your view.

See the answer for Question 58.

Q.79) Do you agree that audit reports should not be required for asset management plan, pricing methodology, prices or contract disclosures? If not, please provide the reasons for your view.

In the response to Question 58, it was noted that independent auditors are very likely to be supporting director's certification of asset management plan disclosures. On that basis, there appears to be a contradiction in the Commission's position that audit reports are required for annual disclosures, but are not required for asset management plan disclosures. If, in a real world process of certifying asset management plan disclosures, directors are supporting those asset management plan disclosures with independent audit reports, it is not much of an extra step to require regulated suppliers to disclose those asset management plan audit reports.

Accordingly, if the objective of information disclosures is to provide reassurance and necessary information for interested persons, then it is appropriate to have independent assurance that the material being disclosed is correct. Independent auditing delivers an effective way of providing that assurance.

Q.101) Do you agree that the Commission's asset management plan review should include a review of the initiatives for energy efficiency, demand-side management and loss reduction that the supplier has included in their disclosed asset management plan? If not, please provide the reasons for your view, an alternative and why you consider this to be preferable.

As noted for Question 59, EDBs are not the best suited entities for energy efficiency and demand-side management. Under the current electricity industry structure electricity retailers, specialist energy managers and EECA are best suited to lead energy efficiency initiatives.

Loss reduction is an activity that EDBs are suited for, but as noted in answer to Question 59, current regulatory constraints can restrict the capability of EDBs to effectively support loss reduction technologies.

It is considered appropriate for the Commission to review the contents of asset management plans for these sorts of issues, so long as the Commission remains aware of the often limited capabilities of EDBs to effectively engage in these

activities, especially in light of the superior capabilities of other entities in those activities.