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SUBMISSION FROM DUNEDIN CITY HOLDINGS LTD

The board of Dunedin City Holdings Ltd (DCHL) and Dunedin City Treasury Ltd (DCTL) wishes to make a submission on the Commerce Commission's (the Commission's) draft determination on Aurora Energy's Customised Price-quality Path (CPP) application.

Context

We write as the board of DCHL, the 100% shareholder of Aurora, and also DCTL, which provides all Aurora's debt funding.

We acknowledge that the Commerce Commission has addressed historic breaches through the penalty imposed on Aurora in 2020 and associated statement of facts, and that decisions on the CPP are focused on the future.

In late 2016, DCHL made the decision to separate the governance and management of Aurora and Delta. We appointed a new board of directors to Aurora and have worked closely with the company during its development as a stand-alone business.

Since 2017, DCHL has supported Aurora's critical re-investment programme. As the Commission is aware, Aurora's expenditure has significantly exceeded what the company can recover through revenue under DPP allowances. Aurora's investment has only been possible because of the funding support lines DCTL has extended.

We have extended this support because we share Aurora's focus on restoring the quality and safety of the network, but this extended financial support is not tenable on an open-ended basis. DCHL needs to ensure, on behalf of the city of Dunedin, that it receives an appropriate return on its investment and that our funding is secure.

We were therefore supportive of Aurora's decision to apply for a CPP. 2020 was the earliest opportunity for this, given the developmental stage of the business and timing constraints imposed by regulation. We have worked closely with the Aurora board to ensure the company is positioned to not only prepare a sound application, but to deliver the CPP programme of work. We consider the company followed a methodical and transparent process and submitted a well-reasoned and appropriate application package, which was largely supported by the Independent Verifier.

We have some significant concerns with the Commerce Commission's draft determination on the application, particularly the reduction in non-network operating expenditure, and the proposed cap applied to annual revenue increase. These concerns are outlined below along with our feedback on the Commission's stakeholder engagement process.

Reduction in non-network operating expenditure (opex)

DCHL does not believe Aurora can deliver the required network investment and business improvement programmes within the Commission's draft reduced non-network opex allowance.

As noted above, we have worked closely with the new Aurora board since 2016 during Aurora's development as a stand-alone business.

We have observed that Aurora has worked hard to attract quality staff to the region for key senior management roles, against a backdrop of a difficult period for the company. We have noted substantial progress being made in the development of the company's culture, systems and processes. Our observations were strongly supported by Toby Stevenson of Sapere, who was commissioned by Dunedin City Council in late 2019 to undertake an independent assessment of Aurora's progress. Mr Stevenson noted the enormity of the task ahead of Aurora, commenting that the company is "doing what they can and should be doing".

There is, however, some way to go before Aurora can be considered a mature business. In our view, the business has only recently stabilised. Aurora's CPP application reflected this, targeting essential safety driven works while continuing the process of maturing capacity and capability, particularly in the areas of asset management and customer service process and capability.

We are very concerned that the proposed reduction in non-network opex would move Aurora backwards. Over the coming years Aurora needs to build on its initial progress and continue to mature. This will require the team and system support that Aurora has acted responsibly to build over the last three years. The Commission's proposed opex allowance will undermine this progress and introduce unnecessary risk to the business.

With this in mind, it is not clear to DCHL how the Commission arrived at its proposed reduction in non-network opex. In our view, Aurora prepared its forecasts based on the company's specific circumstances (including its relative maturity as a new standalone business noted above). The forecasts were then subject to a comprehensive and detailed review by an independent verifier who, we understand, verified around 97% of the company's total forecast expenditure for the next five years against the Commission's expenditure objective (the regulatory test).

The Commission then engaged Strata Energy Consulting to provide further external advice. DCHL has concerns with the weight the Commission appears to have placed on Strata's advice versus the Independent Verifier, when Strata's work appears to have been undertaken as a desktop exercise and did not involve engagement with Aurora. We do not believe, for example, that Strata's choice of companies against which to benchmark Aurora were appropriate or took into account the company's developmental stage or the scale of its investment programme (PowerCo and Orion, for example, are more mature businesses than Aurora).

The reduction in allowed non-network opex to a level lower than what would have been allowed under the current DPP is particularly difficult to understand. This seems at odds with the universally acknowledged need for a step-change in investment at Aurora. It is a decision which, left unchecked, can only undermine the credibility of the CPP process as a viable option for regulated distribution businesses to pursue.

10% limit on annual price increases

While the ability of the Commission to impose a limitation on annual price changes is understood, the grounds for the Commission's selection of a 10% limit to Aurora's annual revenue increase are not clear to DCHL.

We understand the Commission's role is to establish whether Aurora's proposed spending is necessary, efficient and in the best long-term interests of consumers.

We recognise the community's concerns about affordability. This has been a concern for the board of Aurora, and for DCHL/DCTL, and was a key area of Aurora's consultation as it developed its application.

However, the weighting the Commission has given to affordability seems high relative to other aims of the regulatory framework (i.e. have incentives to innovate, invest and to improve efficiency). Furthermore, we believe affordability has not been adequately placed in the context of how Aurora's proposed line charges under its CPP proposal compare with lines charges across other parts of New Zealand.

The Commission has acknowledged the fact that historic low investment has consistently kept Aurora's lines charges among the lowest in the country. The CPP application as drafted would see Aurora's average lines charges move closer to industry average.

We acknowledge the sharp increase that will be felt by consumers by moving from historically low charges, but we believe the line charges proposed in Aurora's CPP application are comparable to those charged elsewhere in New Zealand and accepted by consumers.

We are concerned that the Commission's proposed revenue smoothing does not give adequate consideration to Aurora's financial position. As set out above, DCTL has supported Aurora's network re-investment since 2017 by extending funding lines that would arguably not have been made available by other lenders. An important point to note is that our support has also included accepting the Aurora board's proposal in the CPP application to defer $32 million in revenue beyond the CPP period to help ease pressure on prices. This has put added pressure on Aurora's balance sheet and is at the extreme of what is manageable for Aurora and acceptable to DCHL as shareholders.

Requiring Aurora to debt-fund more of its proven required investment by revenue smoothing unfairly places more of the cost burden on DCHL.

DCTL provided a Letter of Comfort to Aurora as part of the application process. We stand by the Letter of Comfort but note it was provided in the context of a 3-year CPP application. DCHL expects Aurora to demonstrate a pathway back to sustainable levels of debt and we believe the draft decision hinders this.

We do not believe the Commission's proposed 10% limit provides sufficient incentive to Aurora to invest, which is a key aspect of the purpose of the legislation governing regulated services like Aurora's.

Stakeholder engagement process

DCHL also has concerns about the stakeholder engagement process the Commission has undertaken on the draft determination.

DCHL attended the Dunedin stakeholder session on 1 December and noted:

- The definition of "stakeholder" and why or how the invited attendees were selected was not clear.
- The Commission did not adequately facilitate the meeting, allowing some attendees a platform to present misleading and factually incorrect information. The Commission also failed to correct misleading statements made by some attendees. We feel this left genuinely interested customers with incorrect impressions.
- Stakeholder engagement would have benefitted from:
    - Outlining the regulatory environment, which allows lines companies to make a margin and recover costs, vs. the term "revenue"
    - Better explanation of the role of retailers. Language that describes Aurora as charging consumers is incorrect and does not reflect the uncertainty of (and lack of control by Aurora over) retailer behaviour.

- Engagement would also have benefitted from further emphasis of the fact that consumers have had a lower cost of delivery as a result of historic low investment, and that Aurora has not historically earned excessive levels of profit from its customers, as these are areas of common misunderstanding.

DCHL supports the general themes of feedback provided in Sian Sutton's letter to the Commission dated 7 December 2020.

Conclusion

We appreciate the opportunity to make this submission and look forward to the Commission's consideration of the points we raise.

Yours sincerely

Keith Cooper
Chair, Dunedin City Holdings Ltd and Dunedin City Treasury Ltd