COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

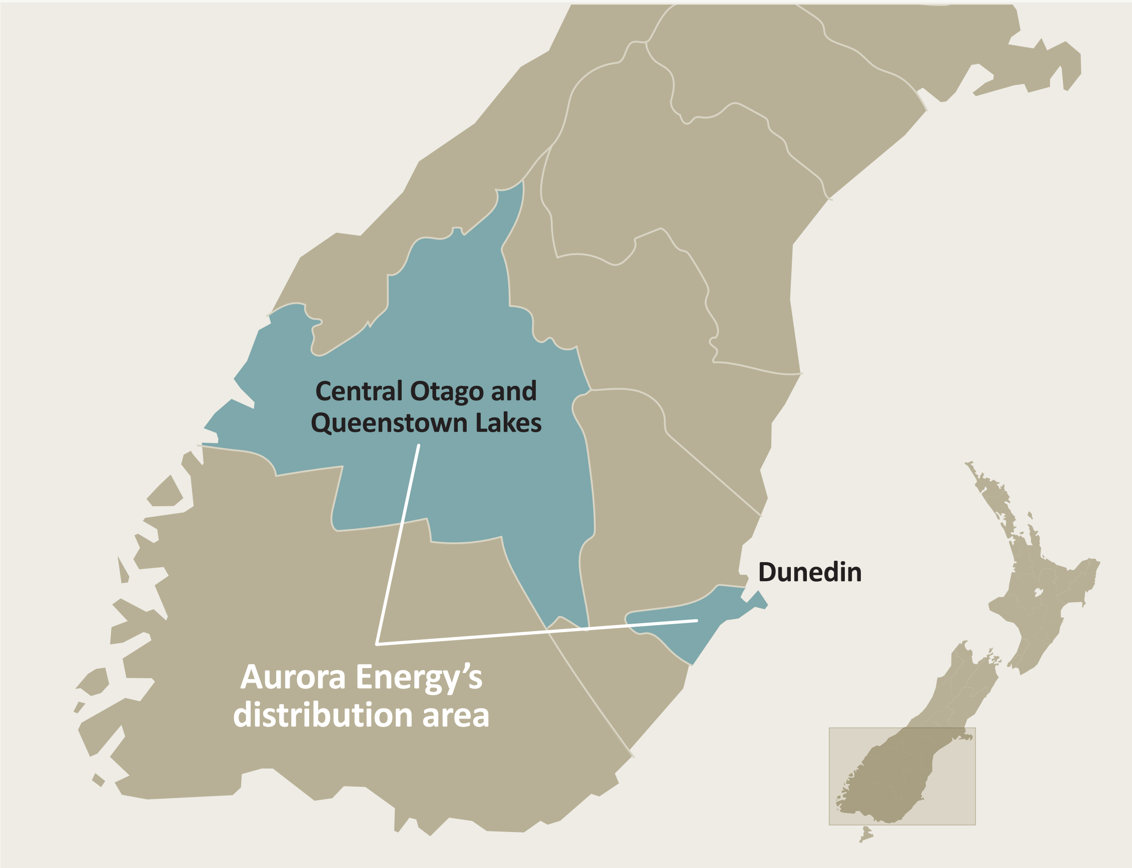
Have your say on Aurora Energy's investment plan

Consumer summary

Key issues paper

About Aurora Energy

Aurora Energy (Aurora) owns and operates the poles, wires and other equipment that distribute electricity from Transpower's national grid to more than 90,000 homes, farms and businesses in Dunedin, Central Otago and Queenstown Lakes. Aurora is a wholly owned subsidiary of Dunedin City Holdings Limited, owned by Dunedin City Council. Aurora's charges are built into power bills and are something its customers are required to pay no matter which retail power company they are with. Currently Aurora's distribution charges make up about 23% (excluding GST) of an average residential customer's power bill. This compares to 27% nationally. The remainder of a customer's bill is made up of the costs of generation, transmission, retail, GST, and a levy to fund the work of the Electricity Authority.



Our process from here

We encourage stakeholders and consumers to provide their views to help shape our draft decision which we expect to make in November. Our final decision will be made in March 2021, with Aurora's new revenue limits, reliability standards and consumer price increases coming into effect on 1 April 2021.

Feedback can be submitted via our consumer submission form at www.comcom.govt.nz/aurora or in writing to feedbackauroraplan@comcom.govt.nz by **20 August 2020**.

Drop-in sessions and stakeholder meetings will also be held in Dunedin, Central Otago and Queenstown Lakes in August. You can find out more information at www.comcom.govt.nz/aurora

Aurora's investment plan

As a result of historic under-investment, Aurora has signalled it requires significant investment over the next decade to fix its network.

On 12 June 2020 Aurora applied to the Commission to charge its customers more to fund a $383 million three year plan to make its electricity lines network safer and stabilise the reliability of its network around current levels to prevent further deterioration. Aurora has also signalled it will make a second investment application for a period of up to five years once it has better asset data allowing it to forecast its expenditure more accurately.

The allowance Aurora is asking for is more than double the allowance of $175 million we set Aurora for the previous three year period. This allowance was largely set using Aurora's own forecast information, which was based on the best information it held at the time.

Aurora says while its historic under-investment in its network helped to keep lines charges lower than the national average over a period of several decades, it has resulted in a gradual deterioration of its equipment and the now urgent need to replace key assets including poles, crossarms, overhead lines, cables and zone substations.

The consequences of Aurora's under-investment have been well publicised since 2016, with an increasing number of safety incidents, including poles supporting live lines falling over. There has also been an increasing number of unplanned power cuts across Aurora's network.

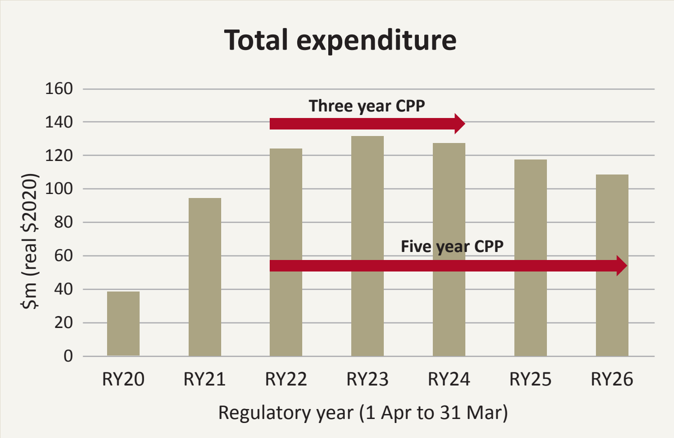
Without additional investment Aurora says its network poses unacceptable safety risks to the public and its workers and there will be more power cuts.

Length of the investment period

By default, investment applications are for a period of five years. However, Aurora has only applied for three years due to the poor quality of its asset data.

The length of the investment period is a decision we make in considering the long-term interests of consumers.

Aurora's proposed spending over the default five year investment period is $609 million. Using an annualised average, expenditure for a three year period is approximately $128 million compared with approximately $122 million over five years.



Even if we approve a three year investment period, Aurora's forecast $226 million of spending in 2025 and 2026 will still be required, so we must decide if we consider this additional revenue now or later.

How power cuts affect households and businesses

For businesses and local economies, power outages can result in staff downtime and a loss of revenue, and for households, power outages can result in loss of perishable items, heating, hot water, and revenue for people who work from home.

Prior to making its application to the Commission, Aurora was required to consult with its customers and stakeholders on its draft plan, as well as having it reviewed by an independent expert.

The expert's report

We have critically reviewed the expert's report by Farrier Swier. We are satisfied by the rigour of their analysis and consider their review to be thorough and undertaken to a high standard. As a result, we are proposing to accept their opinion at a high level and do not intend to duplicate their analysis. In summary, they found that for the three year proposed investment period 64% of Aurora's capital expenditure and 89% of its operating expenditure meets our expenditure objective. The expert's sample review covered 66% of Aurora's capital expenditure plans as they are limited to reviewing up to 20 projects and Aurora had many more projects than previous applications. We are seeking expert external advice on the projects not reviewed to ensure the spending is efficient. The expert came to a similar conclusion when examining the proposed expenditure over the alternative five year investment period. As a result, we intend to target our review primarily on the areas of Aurora's proposal that Farrier Swier suggested we scrutinise further, along with issues that were not identified by them, either because they were out of scope of their process or because we seek further assurance.

As a result of feedback from its customers and Farrier Swier, Aurora's final proposal has been narrowed to primarily focus on safety. Growth-related projects have been deferred due to COVID-19 and the total expenditure Aurora is seeking has been reduced by around $20 million. This has had the effect of reducing proposed price increases for Aurora's customers, though increases to lines charges from April 2021 are still significant.

How much more will Aurora's customers pay?

Under Aurora's plan, monthly electricity distribution charges will increase by between 48-66% for residential customers over their proposed three-year investment period. However, distribution charges are only one component of an average residential consumer's power bill (typically a quarter, excluding GST), with the rest made up of the costs of generation, transmission and retail costs.

When you look at the impact of Aurora's proposal on the total average monthly residential power bill, their proposal would result in an:

→ 11.9% increase for Dunedin customers, or approximately $20 more a month

→ 16.7% increase for Central Otago and Wanaka customers, or approximately $30 more a month

→ 10.6% increase for Queenstown customers, or approximately $24 more a month.

If we approve a default five year investment period, Aurora's proposal would result in a further increase in years four and five of between 2.6 and 3.2%, or approximately $5-$6 more a month depending on where you live.

Aurora's proposed price increases will create a new baseline price for its customers.

Aside from price increases, Aurora's customers can also expect slightly more frequent and longer unplanned power cuts over the next three to five years due to the continued failure of old equipment. Meanwhile, Aurora expects planned power cuts to remain at higher levels, similar to what its customers have experienced over the past two years, as it works to fix its network.

Aurora says in the long-term its investment plan will result in its customers having a safer electricity network which is able to support the level of expected growth in demand for customer connections, as well as the uptake of future technologies. Meanwhile, it expects network reliability will be stabilised around current levels, with improvements possible subject to customer support for additional investment as part of its second investment application to the Commission.

Our role in Aurora's investment plan

The Commission regulates Aurora as a monopoly lines company under the Commerce Act as its customers generally have no choice but to connect to its network. We do this by setting the maximum revenues it can earn from its customers and the minimum quality of service it must deliver.

Typically, we reset revenues and quality standards for most New Zealand lines companies once every five years. However, if a lines company needs to invest substantially more in its network, it can submit a plan to us to change its quality standards and increase its revenues to recover this investment. These applications are called customised price-quality paths (CPP).

Our role is to assess Aurora's investment plan to determine whether it is justified, and to decide what the associated levels of revenue and quality of service should be.

For revenue, this includes how much money Aurora should be allowed to recover from its customers to carry out its plan and over what period. In simple terms, we determine the size of the pie. It is then up to Aurora, using the Electricity Authority's pricing principles, to decide how the pie is cut up between different groups of customers (residential, commercial, industrial and in each of its pricing regions Dunedin, Central Otago/Wanaka, and Queenstown).

For quality, we set the minimum level of reliability customers should receive, as measured by the number and length of power cuts customers experience across the network.

> It is important to note that we are not the safety regulator for Aurora's network. Health and safety regulator WorkSafe is engaging with Aurora on the safety of its network for its workers and communities. However, in considering Aurora's proposal we will take into account the need to invest for safety reasons.

We are acutely aware of the impact COVID-19 has had on Aurora's customers and we are scrutinising its plan to ensure it is well targeted and minimises costs to customers where possible. As part of our assessment we will consider what options there are to manage price shocks, while balancing these against the need to ensure Aurora has enough money to fix its network.

Consumer and stakeholder feedback on our introductory paper

In May we released introductory materials to help consumers and stakeholders better understand our role in helping to fix Aurora's network ahead of Aurora submitting its application to us. We received dozens of emails from consumers and community leaders, many expressing concern about proposed price increases.

Many of these emails also raised issues which are outside our assessment of Aurora's investment application, and in some cases outside the role we are allowed to perform entirely.

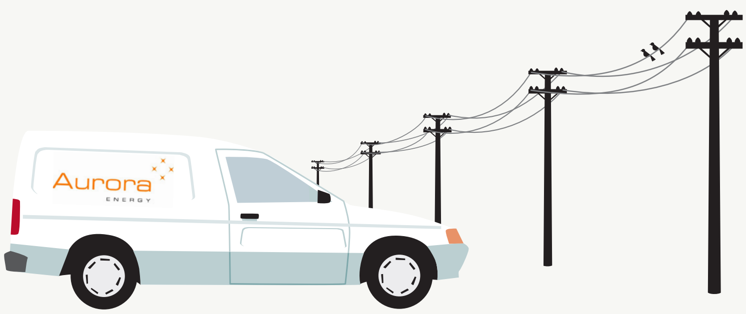
Issues that are outside our role:

Aurora's regional pricing – this is a matter for Aurora and the Electricity Authority. We note that Aurora has signalled it intends to review its regional pricing and consult with its customers in 2023.

Making Aurora's owners pay to fix the network – many consumers, especially those in Central Otago and Queenstown Lakes told us they want Aurora's owners to pay for the cost of fixing the network using dividends paid by Aurora to its shareholder. While we regulate Aurora as a monopoly lines company, we do not regulate Aurora's owners and these matters are for Dunedin City Holdings and Dunedin City Council to respond to.

Consumers also told us they wanted some more information on Aurora's level of profitability. In comparing Aurora's profitability over the past seven years against our allowable rate of return, we found no evidence of Aurora making excessive profits. This finding is supported by our 2016 assessment on electricity distributors' profitability and the Government's recent Electricity Price Review. We also note Aurora's profitability has reduced significantly in recent years as it has begun to address its historic under-investment.

Consumers also wanted us to hold Aurora to account for its past failings. Our role in this application is forward-looking and focussed on doing what is right for the network now for the long-term benefit of consumers. However, our work in helping to fix Aurora's network is broader than assessing this investment application. In March 2020, our proceedings against Aurora for breaching our network quality standards, through an excessive level of power cuts in the 2016-2019 years, concluded in the High Court with Aurora being ordered to pay a penalty of almost $5 million. Aurora has indicated it will not pass this cost onto its customers and is talking to the Government about whether the penalty money can be reinvested into its communities. In 2018 we also encouraged Aurora to undertake an independent assessment of the state of its network to provide a high-level view of the key issues on its network and areas where future investment should be prioritised. That work has helped to shape Aurora's investment plan.



Key issues arising from our initial assessment of Aurora's proposal

The primary purpose of this paper is to seek your feedback on key issues we have identified in our initial assessment of Aurora's investment plan. We welcome feedback on these issues, along with any other issues you think we should consider.

At a high-level, key issues include the following topics:

Options for minimising consumer price shocks – Given the scale of Aurora's proposed price increases we are considering if expenditure might be deferred, reduced or recovered over a longer period to minimise sharp price increases for consumers. It is important to note that the options we are exploring do not avoid the costs associated with fixing Aurora's network, rather they adjust the profile of the price increases over time to make them more manageable for consumers. In addition, any costs shifted into the future also incur an interest expense to reflect the higher cost of financing, so the total amount recovered from consumers will be higher as a result. In making our decisions we also need to consider what impact these will have on Aurora's financial stability and its ability to fix its network. We want to know whether you would prefer prices to rise immediately but in gradual and steady increments or if you would prefer a smaller price rise in the first year followed by larger increases in the following years to allow more time to prepare? We also want to know if you would be willing to pay more in total due to interest costs in order to smooth the price increases over a longer period.

Length of the investment period – Investment periods can be between three and five years, with five years being the default. The length of the investment period is a decision we make and we would only depart from the default period if we considered it was in the long-term interests of consumers. To ensure we have sufficient information to make our decision, Aurora was required to provide a full five years of forecasts and data, though it has requested we approve the three year investment period which it consulted on. Aurora says its asset data makes it hard to accurately determine its investment needs past three years and a shorter period gives it time to improve its asset data before submitting a second application for a period of five years. However, we have concerns that the law may prevent Aurora from submitting a second investment application to us until 2026. We also consider that a five year investment period may have options to address some of the concerns Aurora has. We want to know what you think we should consider in making our decision on the length of the investment period and whether you have any concerns with either a three or five year period.

Planned power cuts – Aurora is forecasting that planned power cuts (ie, scheduled outages for things like maintenance and replacement of equipment, and tree trimming work) will remain at similar levels over the next few years as they have been over the previous two years, when it substantially increased the level of work it carried out on its network. It forecasts about 154 minutes of planned power cuts per customer in 2021. This steadily reduces to about 118 minutes by 2024 and 75 minutes by 2026. While the level of power cuts needs to be scrutinised to ensure it represents efficient delivery of Aurora's work programme, we are interested in your views on the timing and length of planned power cuts and how you would like Aurora to communicate with you.

Unplanned power cuts – Aurora is proposing to increase the maximum limits we allow it for the duration and frequency of unplanned power cuts across its network (eg, equipment failing in bad weather). Aurora says this is to reflect the realistic performance of the network given its deteriorated state. It is forecasting that on average, customers can expect about 111 minutes of unplanned power cuts (excluding the full impact of severe weather events which can be volatile and difficult to predict) per year over the investment period. This is regardless of whether it is three or five years – up about 4% on the previous investment period. Aurora says without investment, this figure would be much worse. It anticipates reliability beginning to improve again towards the end of 2024. We want to test whether consumers would be willing to pay more for less frequent and shorter power cuts at this time. We want to know what Aurora can do differently to better manage and communicate with you about both unplanned and planned power cuts, including what good communications with you looks like. We are also interested in consumer views on Aurora's scheme where it pays compensation to customers if it fails to meet service levels, and on any financial incentives Aurora should face to undertake planned work and minimise the duration of unplanned power cuts.

Effectiveness of consumer consultation – Aurora consulted with consumers and stakeholders on its draft plan. The independent expert's view is that Aurora met the requirements for consumer consultation and listened to consumer feedback in developing its final proposal. We want to know if there is anything Aurora did not properly consider in its investment application. We also want to know if your views have changed since the consultation was undertaken (eg, because of the COVID-19 pandemic) or if there is anything else you want to bring to our attention.

Aurora's ability to deliver on its plan – It is important that Aurora delivers its plan on time, to budget, and that the work completed is of a high quality so consumers get the benefits of what they are paying for. We want to hear whether you think Aurora will be able to deliver on its plan and whether you have any specific concerns around non-delivery, late delivery, or inferior delivery. We also want to know how you would like Aurora to be held to account for completing the work. For example, requiring it to report on progress including meeting in person with its communities, as well as what level of detail you would like to see in these reports (eg, on safety improvements and targets) and how often.

Impact of the COVID-19 pandemic – The implications from COVID-19 are still emerging but we already know that the economic fallout is affecting growth and demand forecasts in Aurora's communities. The pandemic and any associated sustained economic downturn also has the potential to increase labour and material costs and affect Aurora's ability to complete the work with travel restrictions and sickness. Given the likely reduction in growth and demand, Aurora has deferred major growth projects and we are considering whether there are further projects that can be deferred. We are interested to hear your views on how we might allow for uncertainty associated with COVID-19 to mitigate risks including that we under or over approve spending.

Operating expenditure (opex) – Aurora is proposing to spend $156 million over its preferred three year investment period, up about 65% on its $94 million allowance for the previous three year period. For a five year period it is proposing $253 million – up 75% on its $145 million allowance for the previous five year period. Its proposed spending is to address a maintenance backlog, be more proactive with network inspections and tree trimming, and improve its asset management for the longer term. Examining Aurora's opex is a priority for us as all of the forecast spending we allow is recoverable from consumers during the investment period. In contrast, the recovery of capital expenditure is spread over the lifetime of the equipment. We plan to further scrutinise some areas identified by the independent expert including how Aurora is forecasting its spending on tree trimming, staffing, and business support. We welcome your views on the overall appropriateness of Aurora's opex proposal. We also want to know whether you agree with the areas we plan to examine further, as well as any other issues you believe deserve further scrutiny.

Capital expenditure (capex) – Aurora is proposing to spend $228 million on new equipment over its preferred three year investment period – nearly triple its $81 million allowance for the previous three year period. For a five year period it is proposing $356 million – more than triple its $115 million allowance for the previous five year period. Aurora says a key driver for much of its proposed spending is to address safety issues and replace equipment before it fails (eg, poles, cables, crossarms, overhead lines, and zone substations). We must determine whether the safety expenditure required to meet statutory and minimum design standards is cost effective. We are interested in your views on whether the expenditure appears to be targeting the right assets for renewal at the right time. If not, we want to know what you think Aurora should focus its network expenditure on.

ISBN 978-1-869458-31-7