COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

Summary of our proposed decisions on Aurora's investment plan

Foreword

It is vitally important that any infrastructure is maintained and renewed at the right time so that it can be used reliably and safely for as long as necessary. Where this does not happen, the cost of restoring the infrastructure will be higher than otherwise and those dependent on it will not receive the level of service they need.

Unfortunately, over the past decade, the safety and reliability of Aurora Energy's electricity lines network has steadily deteriorated through a lack of investment. It is generally accepted that having underinvested in maintenance and replacing old assets for many years, Aurora now needs to spend more to make its network safe and prevent a further increase in power outages.

Aurora began taking steps to repair its network in 2017, and its application for a customised price-path (CPP) is a continuation of this process. It took a long time for its underinvestment to cause problems in its network, and it will be some years before this is fixed.

The scale of Aurora's proposed investment and related price increases, along with the known community concern over network safety and power outages, means that public engagement with this process has been, and will continue to be, particularly vital.

We want to thank Aurora's customers for engaging with us so clearly and constructively over these past four months. At a time when COVID-19 has severely impacted the local economy, with no certainty as to when the recovery may come, we know an increase in energy bills will come at a difficult time for Otago communities.

Through our town hall meetings, online sessions and traditional written submissions, Otago consumers have expressed their disappointment, anger and frustration with the situation they find themselves in. We understand that they want a safe and reliable electricity supply but we recognise they remain deeply concerned about whether they can afford to pay for it.

Communities in Central Otago and Queenstown Lakes, in particular, have made it clear they do not have any trust or confidence in Aurora to deliver what it says it will. Individuals and businesses told us of their concerns about subsidising Dunedin and their desire for Aurora and its owners to be held further accountable for past failures.

These grievances and concerns are understandable. However, we have already taken Court action to prosecute Aurora for breaching its reliability standards, for which it was fined $5 million. It will also be unable to recover from its customers around $40 million of the expenditure it has undertaken from 2017 to the start of the CPP.

This CPP process cannot relitigate those historical failings, decide who can and cannot own Aurora's assets, or direct its management on how to run its business. It is our responsibility to assess Aurora's application and its accountability within the legal framework set out in Part 4 of the Commerce Act and the regulatory rules we must abide by.

Ultimately, this requires us to assess whether its investment plan is well-justified, and if its spending will be efficient. We are required to look forward and focus on the long-term benefits to consumers from a safe and reliable network, rather than whether now is the right time to require consumers to pay more for their electricity supply.

The CPP is the mechanism available within New Zealand's regulatory framework through which lines companies can seek additional funding to undertake substantial and necessary work, whether that is to grow or fix their network. In our view Aurora has made the case that without this CPP its network would continue to deteriorate and result in worsening outcomes for its customers – particularly in the reliability and quality of its electricity supply.

The expenditure is needed and will result in significant price rises. However, our assessment has found areas where we did not think expenditure was justified or could be delayed into the future. As a result, our draft decision would allow for lower levels of spending than Aurora has applied for, which would reduce the impact on consumers' energy bills.

Consumers facing higher bills resulting from increased expenditure will want to be confident that Aurora is spending their money wisely, and that it will consider the needs of different communities when planning its work. Alongside our draft CPP decision, we are also announcing plans for a wider range of measures to improve Aurora's accountability to different communities across it network, and to us.

The information disclosure requirements we are planning would include requiring Aurora to publish an Annual Delivery Report, detailing its progress against its plan, and present it to customers in each of its three regions. In addition, we want to improve Aurora's reporting on the quality of its services and its transparency around how it calculates its regional prices.

Together, our CPP draft decision and planned reporting requirements present a package of measures that we consider would help improve Aurora's performance over time.

We welcome feedback on our response to Aurora's plan, and Commission representatives will shortly be heading to Alexandra, Cromwell, Dunedin, Queenstown and Wanaka to hear directly from these communities once more.

Sue Begg
Deputy Chair

John Crawford
Associate Commissioner

Derek Johnston
Commissioner

Elisabeth Welson
Commissioner

Executive Summary

On 12 June 2020, Aurora Energy Limited (Aurora) filed an application for a customised price-quality path (**CPP**) to increase its regulated revenues in order to repair its electricity lines network and recover the cost of its spending from its customers.

This paper details the package of measures we are proposing in response to Aurora's application, including our draft decision on its CPP and some broader requirements to improve its accountability to customers across its network.

Aurora is subject to price-quality regulation under Part 4 of the Commerce Act. This means that we determine the maximum revenue it can recover from its customers and the minimum quality standards – measured in terms of the number and duration of outages on its network – it must meet. As with all lines companies, we can also impose additional requirements on Aurora in terms of information and engagement.

Until now, Aurora has been on a default price-quality path (**DPP**). The DPP is the standard regulatory assessment we undertake every five years for larger lines companies, based on their previous performance and spending forecasts.

As a result of historic underinvestment, the safety and reliability of Aurora's network has deteriorated significantly in recent years. This resulted in Aurora breaching the quality standards we had set it between 2016-2019, for which we prosecuted it in Court and it was fined $5 million.

Having recognised the deteriorating condition of its network, in 2017 Aurora began increasing its investment and maintenance spend to urgently address safety risks. It subsequently filed an application for a CPP as it believes its current DPP will not meet the spending required to continue this work and operate a safe network at current levels of reliability. By applying for a CPP, Aurora is seeking a bespoke price-path based on a close assessment of the current state of its network and proposed investment plan.

Aurora proposed to spend a further $383 million over three years, or $609 million over five years, to replace ageing infrastructure and run its network. This is around $120 million or $177 million more respectively than what it would be permitted to recover under the current DPP, which began on 1 April 2020.

We understand the disappointment and anger Aurora's customers hold about the position the business is in. Aurora has nevertheless largely made its case for urgent and ongoing investment in its network. Without this CPP, its network would continue to deteriorate, safety incidents would increase, and customers would experience more frequent and longer outages.

Aurora preferred a three-year CPP period, but we consider a five-year period offers greater long-term benefits for its customers. We have assessed Aurora's plan and our draft decision would lower its proposed spending from $609 million to $523 million – a reduction of $86 million (14%). This would be made up of:

- $315 million of the $356 million proposed for capital expenditure
- $208 million of the $253 million proposed for operating expenditure.

Our draft decision on Aurora's capital spending reflects our view that it has largely made the case for increased investment in replacing old and failing assets. The difference is mostly attributable to the timing of when this work is required. We do however consider Aurora has overestimated the amount of money it needs to run its network, which has led us to propose a substantial reduction of $45 million (18%) in its operating spending.

Our role is to set the maximum revenues Aurora can recover from its customers as a whole – we cannot control how this is priced for individuals or regions. It is open to Aurora to set its prices at any level within the revenue cap we have set. However, if it was to recoup less revenue than it is allowed in any given year, it can recover the remainder (along with interest) at some future date.

In its application, Aurora estimated the impact its spending would have on total monthly energy bills in 2023-2024 compared to 2020-2021 prices. As Aurora's estimates did not include GST or inflation, we have adjusted its figures to include these relevant factors and compare them with our draft decision.

Table 1 Estimated total monthly bill price increase ($) as at 2023-2024

	Dunedin	Central Otago and Wanaka	Queenstown
Aurora CPP application *(excl GST and inflation)*	20.30	30.90	24.10
Aurora adjusted	32.70	47.30	39.80
Draft Decision	22.20	31.50	22.70
Difference	**-10.50**	**-15.80**	**-17.10**

Our analysis indicates our draft decision would reduce the increase in lines charges by between 30% to 40% compared to Aurora's plan. However, the total increased investment we have allowed, including some already undertaken, would still result in substantial price rises.

We estimate that lines charges alone could increase by $3 to $13 per month for the majority of Aurora's residential customers from 1 April 2021. This would rise to between $20 to $73 per month by 2026. Depending on usage and where they live, some customers may fall outside this range. As our estimates are based on the capital and operating expenditure draft decisions, any changes to these spending allowances following submissions would flow through to lines charges in our final decision.

Given the state of Aurora's network, we consider that its quality standards should be adjusted to better reflect its likely performance. In practice, we consider Aurora should be capable of meeting targets on the number and duration of network outages that are higher than historical levels up until 2015, but similar to what it has actually been achieving over the past five years.

We also want to improve Aurora's accountability for work across its network. Alongside our draft decision, we are planning a series of measures that would require Aurora to provide greater transparency on the delivery of its plans, the quality of its services and its pricing. This will not be dealt with in the CPP itself, but through a complementary package of information disclosure requirements.

Our package of measures is intentionally focused on the long-term benefit to Aurora's customers. It will take some time, and cost, to put Aurora back on the right track, but Otago consumers will eventually be better off having Aurora invest in the security and reliability of their electricity supply.

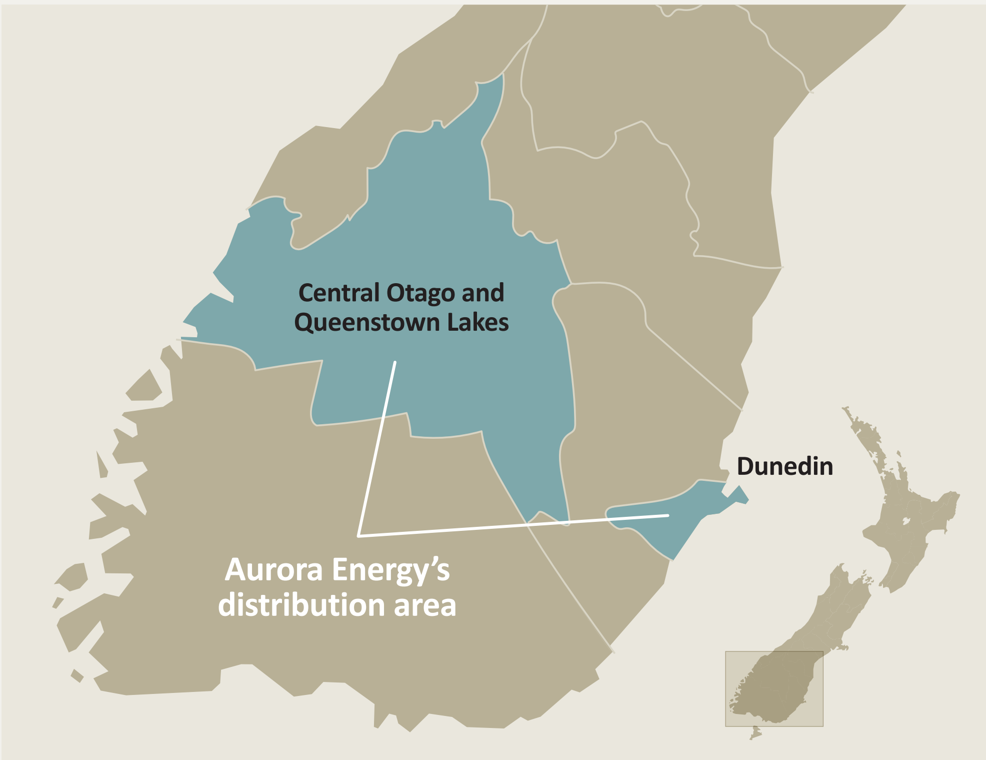
We are now seeking feedback on our draft CPP decision and the overall package. We have arranged a series of public meetings for Aurora's customers and stakeholders before submissions close on 10 December 2020. Our final decision is due by 31 March 2021.

Context of Aurora's CPP

Aurora owns and operates New Zealand's seventh largest electricity lines company by consumer connection numbers. Its network provides electricity lines services to about 90,000 customers in Dunedin, Central Otago and the Queenstown Lakes District.

Aurora is a wholly owned subsidiary of Dunedin City Holdings Limited, which in turn is owned by Dunedin City Council.

Figure 1 Aurora Energy's distribution area



Historic underinvestment

The core of Aurora's network was predominantly built in the 1950s and 1960s. As it has aged, the condition of its assets has deteriorated and the risk to the public and its employees has increased.

There have been a number of well-documented safety incidents in recent years, including both power poles and live electricity lines falling to the ground. Aurora's records show that, collectively, there were over 300 overhead lines, pole and crossarm failures between 2015-2018, of which 49 were classed as serious hazard events.[1]

Aurora's ageing network has been inadequately maintained due to underinvestment going back many years. As a result, it is providing an increasingly less reliable service to consumers. The average number and duration of outages has increased significantly over the past 10 years and would continue to worsen if action is not taken.

Aurora's level of underinvestment over many years is consistent with its relatively low historical revenues. This can be seen when comparing a snapshot of its revenue on a per customer basis with that of all the other electricity lines companies in New Zealand over the 2013-2019 period.

Figure 2 Aurora's revenue per customer per year 2013-19 (dashed line is the average)

If Aurora had recouped the average revenue per customer of the 17 price-quality regulated lines companies, then each of its customers would have paid on average $321 more per year in lines charges over this 2013-2019 period (inclusive). In other words, Aurora's customers have collectively been paying less for their electricity lines services in recent years when compared with most New Zealanders, particularly when accounting for the geography of its network.

Furthermore, Aurora's profit on a per customer basis over the same 2013-2019 period was among the lowest of all lines companies. This implies Aurora has not earned excessive levels of profit from its customers. Rather, it appears its low level of investment enabled it to maintain artificially low prices for its customers over many years (potentially decades).

Aurora could have applied for a CPP at any point over the past decade but did not. As a result, it is in catch-up mode and needs to undertake a significant amount of investment over a short period of time to improve safety and stabilise the reliability of its network.

1. WSP Independent Review of Electricity Networks – Aurora Network Final Report Table 7.2 p. 48, available at https://www.auroraenergy.co.nz/assets/Independent-Review-Mar-2018/WSP-Final-Report-PS109832-ADV-REP-003-RevD.PDF

Aurora's plan

In recent years, Aurora recognised the deteriorating condition of its network and began significantly increasing its investment and maintenance spend to urgently address safety risks. Much of this work was guided by the 2018 WSP state of the network report we encouraged Aurora to commission following our investigation into its quality standard breaches.

Through its CPP application, Aurora has sought approval to increase its prices to cover part of the cost of the additional expenditure to date, but also to fund a continued large expenditure programme from April 2021.

Aurora applied for a three-year CPP as opposed to the five-year default period, as it believed its forecasts that underpinned its application were more robust for the initial three years compared with years four and five. It signalled it would then make a second application for the following five years, once it had better asset data allowing it to forecast its expenditure more accurately.

In developing its plan, Aurora undertook its own community consultation. This included a series of public meetings, consumer surveys and the publication of a consultation document that its customers could provide written submissions on. It also established a Customer Advisory Panel (CAP) to provide an independent consumer voice to help inform its plan.

In its CPP application, by 2023/2024 Aurora estimated its spending plan would result in energy bill increases of:

- 12% for Dunedin ($20 a month)
- 17% for Central Otago and Wanaka ($30 a month)
- 11% for Queenstown Lakes ($24 a month)

However, as noted, these estimates do not include GST or account for inflation, and so understate the price increase consumers will see in their energy bills. Our own analysis of Aurora's estimate and the impact of our draft decision on lines charges is explained in greater detail further below.

Independent verifier

As part of the CPP process we agreed with Aurora to appoint Farrier Swier Consulting and GHD (together, the Verifier) as an independent expert to assess its proposal and provide a report to accompany its application. With the assistance of Strata Energy Consulting, we then tested the verification report and the techniques and methods the Verifier used to assess Aurora's proposal.

Overall, we considered the Verifier's report to be generally robust. It assessed the bulk, but not all, of Aurora's proposal and identified areas it considered we should review further. As a result of our review, our findings are materially different from the Verifier's conclusions in some parts but not in others.

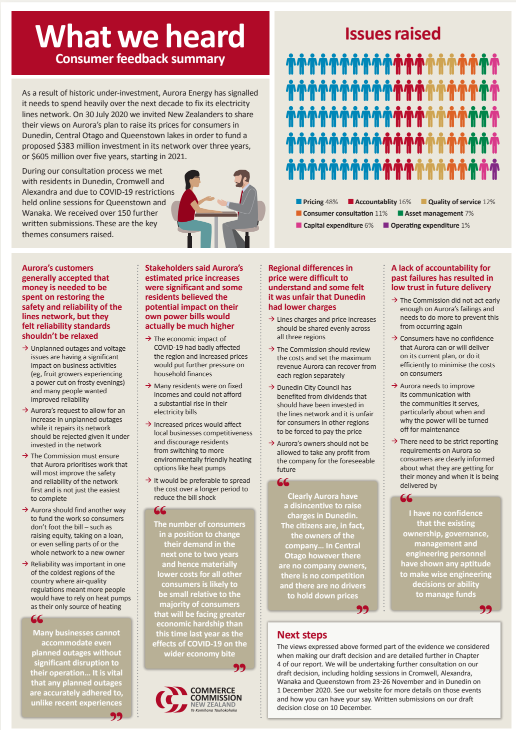
What Aurora's customers told us

Given the scale of Aurora's proposal and likely price impacts, we recognised that it was important for us to engage directly with Aurora's customers, and make ourselves and our processes as accessible as possible for them, in order to understand fully their views and concerns.

On 30 July 2020 we released an Issues Paper package describing the key issues we had identified from our initial assessment of Aurora's proposal on which we wanted to hear from stakeholders. We followed this with a series of public meetings with local residents in Dunedin, Alexandra and Cromwell. Planned meetings in Queenstown and Wanaka unfortunately needed to be cancelled due to a sudden change in COVID-19 alert levels and were instead held online.

The feedback we received when talking with stakeholders and residents in Dunedin, Central Otago and Queenstown Lakes broadly covered the same themes and issues addressed in the written submissions we received.

Figure 3 What we heard



During consultation we received a range of views, not all of which we could take into account or act on as part of the CPP process. In assessing submissions, we broke down the issues raised into three broad categories:

- Issues we can deal with using the mechanisms and tools that are provided for under the CPP regime;
- Issues within our responsibility that cannot be dealt with using the mechanisms and tools available to us under the CPP regime, but can be managed using our other powers and tools at our disposal (such as information disclosure); and
- Issues that are outside our control and are more for other government agencies, the government itself or other non-government entities.

The core issues raised in submissions that we can deal with during this CPP process are detailed further below in our draft decisions.

What we cannot do

Submitters raised a number of issues during consultation that, although relevant to Aurora's business activities, sit outside our responsibility or ability to address.

Table 2 Issues raised and responsible authority

Issue	Responsible
Regional pricing	Electricity Authority
Price increase for distributed generation	Electricity Authority
Ownership contribution to network rebuild	Dunedin City Holdings and Dunedin City Council
Electricity market structure	The Government (via MBIE)
Health and safety practices	Worksafe NZ

Three issues in particular were raised frequently with us during the public meetings and in written submissions. These were:

- Affordability of price rises
- Aurora's ownership
- Regional pricing differences.

Affordability

Submitters told us the proposed price rises would impose financial stress on many of Aurora's customers and was especially problematic for those on fixed incomes who may already be struggling due to the impacts of COVID-19 (notably super annuitants and those on welfare).

Price rises would also create difficulties for a region that has cold winters and is increasingly reliant on electric heating for air-quality reasons. They could also potentially harm the competitiveness and viability of some commercial customers who feared they would face large price rises at a time of reduced demand in the economy.

We accept the communities' concerns about the potential financial impact of price rises on individuals and businesses and understand that some consumers are worried that their income cannot stretch to cover a price rise. However, we have limited ability to address affordability and energy poverty issues as part of the CPP process or through our wider powers under the Commerce Act.

We are required to assess the facts of Aurora's application: whether its proposed spending is necessary, efficient and in the best long-term interests of consumers. To the extent we are able to take considerations of price shocks and affordability into account we have done so, such as smoothing revenue over time.

We set the maximum revenues Aurora can recover from its consumers as a whole but cannot control how this is priced for individual customers. It is open to Aurora to assess affordability in any price increases it may wish to implement. But there is a cost to its customers in doing so, as ultimately Aurora can recover these deferred revenues (along with interest) at some future date.

Aurora’s ownership and governance

Many submitters felt that Aurora’s owners should bear most of or all of the cost of fixing the network. They considered this could be achieved by requiring the owners to take out a loan, pay back past dividends or sell part of the network and use the funds obtained to pay for the repairs. Some submitters further argued that as Dunedin customers owned the network, via Dunedin City Council, only they should pay.

Under Part 4 of the Commerce Act we can only regulate Aurora’s operation as a lines company. We do not have the power or ability to decide who owns a lines company or direct the owners on how to manage or invest in their business. These matters are ultimately for the owners, Dunedin City Holdings and Dunedin City Council.

Regional pricing differences

Aurora divides its network into three regions for the purposes of charging its customers: Dunedin, Central Otago and Queenstown Lakes. Submitters raised several concerns about the fairness of this pricing approach, with residents in Central Otago and Queenstown Lakes saying they believe they are already subsidising Dunedin and expect it to get worse.

The responsibility for network pricing lies primarily with Aurora with oversight of another regulator, the Electricity Authority. It is aware of these concerns from its participation in the public forums.

We do consider that Aurora should be required to explain its pricing approach and regional calculations to its customers in different parts of its network through our information disclosure requirements.

Our proposed package

The core aspects of Aurora’s application that we consulted on, and which we provide further detail on here, include:

Under the CPP

- The length of the CPP period
- Allowable revenue and price smoothing
- Capital expenditure
- Operating expenditure
- Service quality and reliability.

As part of the wider package

- Accountability and delivery.

Having reviewed Aurora’s proposal, and assessed it against the framework and evaluation criteria set out in the rules and legislation that apply to us (which includes considering stakeholder views), we accept that the majority of Aurora’s proposed investment is prudent and necessary to fix its network.

While our draft decision would reduce the amount of expenditure Aurora can recover over the next five years, compared to what it proposed, it will still result in substantial price rises for its customers.

Five-year CPP

Although Aurora requested a three-year CPP period, our analysis of its proposed service quality and expenditure led us to consider that the default five-year period would better meet consumer's interests over the longer term.

Where there may be uncertainty with Aurora's forecasts in years four and five, primarily around capital expenditure needs, we are proposing to put contingency mechanisms in place that manage the risk of setting the revenue too low by providing some flexibility to deal with changing circumstances.

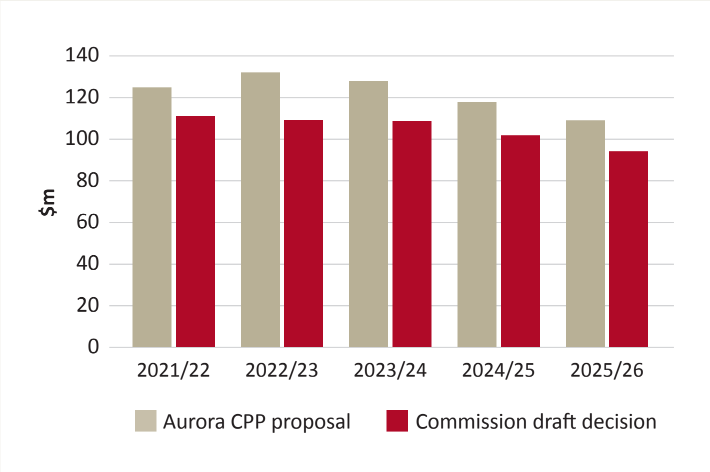
In our view, a five-year period best meets the purpose of Part 4 of the Act and provides greater certainty to both Aurora and its customers to plan for the impacts of this investment.

Allowable revenue and price smoothing

Aurora proposed to spend $609 million to fix and operate its network over the next five years, which would need to be recovered through an increase in its lines charges.

Our draft decision would reduce Aurora's expenditure to $523 million over the five-year period. The difference for each year of the CPP period is shown below:

Figure 4 Aurora's total proposed expenditure



As mentioned, Aurora estimated the regional price impact of its plan would range from $20 to $30 per month by 2023-2024. This estimate was based on a three-year CPP and did not fully include GST or account for inflation. Aurora did, however, signal further price increases would be required in the future through a second CPP application.

In addition to the revenue we would allow Aurora to recover during the CPP period, we must also account for what it is already spending to fix the priority issues it has identified in its network.

During its most recent regulatory period (2015-2020), Aurora has spent considerably more than its approved expenditure allowance under the DPP to repair its network and replace assets including poles, overhead lines and transformers.

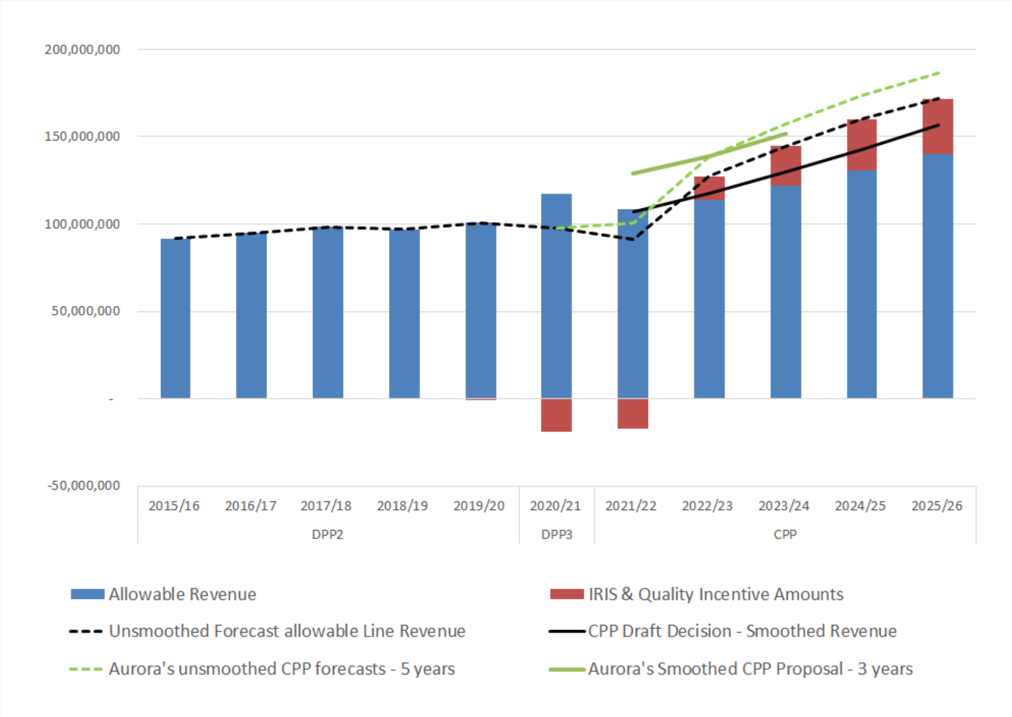
It did so ahead of our decision on its CPP as it had identified work that needed to be actioned immediately and kept us informed of its progress to address its network restoration.

Where an electricity lines company spends more than is set out in its DPP allowance, the price-quality regulatory regime requires it to absorb some of that extra spend itself. However, to ensure it does not delay necessary work, it is entitled to recover the greater part of this expenditure from its customers in future years.

In the case of Aurora, we have estimated that over time it can recover $136 million of its approximate $174 million overspend. Aurora proposed to defer recovering parts of this spending (shown as IRIS and Quality Incentive Amounts in the graph below) immediately and instead spread it over eight years. This would have left around $32 million to be recovered beyond the CPP period.

We agree with the intent of what Aurora has proposed, but have taken a different approach using a combination of mechanisms available to us to achieve a similar effect and smooth price impacts for consumers. The impact of our draft decision on Aurora's proposed allowable revenue is shown in Figure 5.

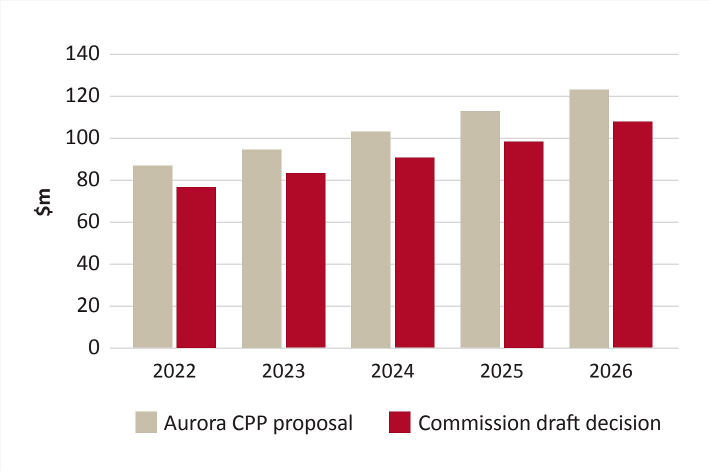
Figure 5 Forecast allowable lines charge revenue $



As part of our consultation process, we sought feedback from Aurora's customers on options for managing the impact of increased lines charges on their electricity bills. Consumer views were balanced on how to manage the impact, with a slight preference for price rises to be spread over a longer period to reduce the immediate bill shock.

Our draft decision is to 'smooth' Aurora's revenue into the future, which would see it increase by no more than 10% every year of the CPP period starting from 1 April 2021. Cumulatively, we estimate that by 2026 lines revenue would increase by 54% for Dunedin, 76% for Central Otago and Wanaka, and 60% for Queenstown Lakes.

Figure 6 Proposed net allowable revenue $m (excl transmission and IRIS)



The above 'smoothing' approach to setting Aurora's maximum allowable revenue would not account for all of its recoverable expenditure during the CPP period. Approximately $9 million would still need to be recovered in subsequent years in addition to the $32m Aurora has offered to defer.

While we cannot specify Aurora's pricing methodology, we modelled several scenarios based on its current pricing approach to estimate the likely impact on consumers. We also instructed independent experts, Castalia, to review our methodology for accuracy.

Taking into account the five-year period, GST and inflation, our estimates are materially different to what Aurora consulted on and the impact on consumers is significantly greater. Inflation alone, for example, adds approximately an additional 8% to lines charges by 2025/26.

We have adjusted Aurora's 2023/2024 estimate in its application to include these additional factors and provide a comparison with our draft decision, as shown in the table below:

Table 3 Estimated total monthly bill price increase ($) as at 2023-2024

	Dunedin	Central Otago and Wanaka	Queenstown
Aurora CPP application	20.30	30.90	24.10
Aurora adjusted	32.70	47.30	39.80
Draft Decision	22.20	31.50	22.70
Difference	**-10.50**	**-15.80**	**-17.10**

The following graphs show the estimated average prices in dollar terms for low, medium and high residential electricity users for each of Dunedin, Central Otago (and Wanaka) and Queenstown Lakes for the five years of the CPP when compared to 2020/2021. These are estimates of the lines (distribution and transmission) charges alone.

Figure 7 Dunedin Residential Annual Lines Charges

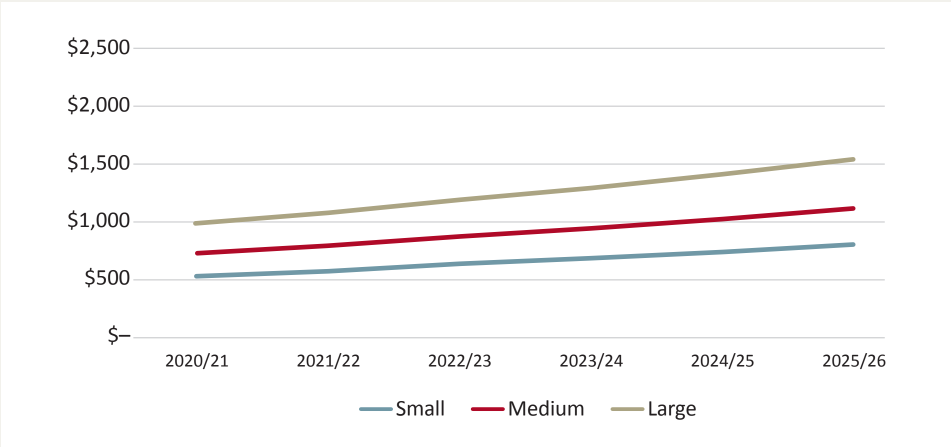


Figure 8 Otago Residential Annual Lines Charges

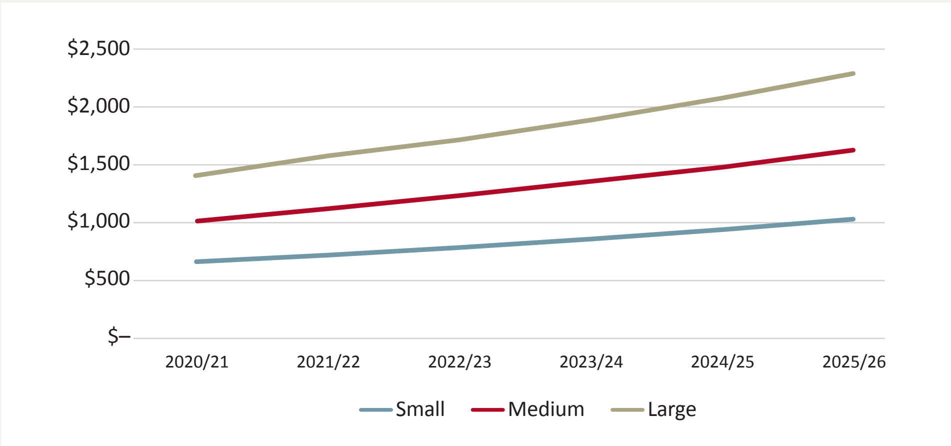
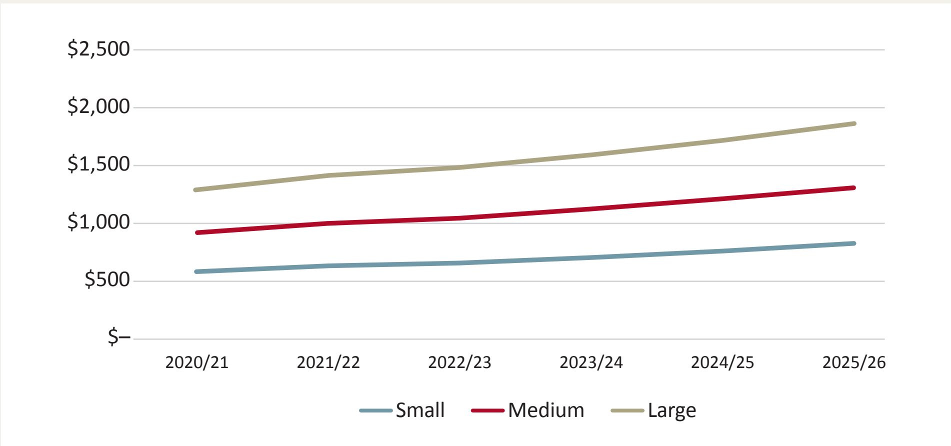


Figure 9 Queenstown Residential Annual Lines Charges



Using these same numbers along with forecast retail electricity prices, we estimate the impact on the average total residential energy bill would be 3% for Dunedin, 5% for Central Otago, and 4% for Queenstown Lakes from 1 April next year. This would rise to 24%, 31% and 20% respectively by 2026.

Alternative scenario

An alternative scenario we can consider is to raise revenues immediately by 5% in the first year, with increases of 10% for each of the next four years.

As an example, the difference between our draft decision (Scenario 1) and the alternative scenario (Scenario 2), is shown in the below table for a medium residential electricity user.

Figure 10 Comparison between Scenario 1 and 2 of residential monthly line charges

Increase in Residential Monthly Lines Component relative to 2020/21 – Medium Consumer Profile					
	2021/22	2022/23	2023/24	2024/25	2025/26
Scenario 1					
Dunedin	$4.70	$11.60	$18.10	$24.90	$32.40
Central Otago	$9.40	$17.50	$27.50	$39.10	$51.30
Queenstown	$7.10	$10.80	$17.40	$24.80	$33.00
Scenario 2					
Dunedin	$2.10	$8.70	$14.90	$21.40	$28.60
Central Otago	$4.20	$11.90	$21.50	$32.50	$44.10
Queenstown	$3.40	$6.80	$13.10	$20.20	$28.00

Under Scenario 2, Aurora's customers would pay less upfront, which may be desirable at this time. However, it would result in $38 million needing to be recovered after 2025-2026 and would likely keep lines charges higher for longer. Consumers would end up paying an extra $10 million over time under this scenario, when accounting for inflation and interest costs.

We also considered spreading the cost over a longer period but this would have the effect of increasing bills for longer and affecting Aurora's cashflow, which in turn may affect its ability to invest in its network.

Our initial preference for Scenario 1 reflects our concern that a substantial amount of revenue could be pushed into a potential second CPP application, beginning in 2026/2027, or the DPP. Inflation and interest costs could also increase and add to the overall cost burden on Aurora's customers for a longer period.

We are acutely aware of the significant impact COVID-19 and the economic slowdown has had on the Otago region, given its drawcard as a tourism destination. With the national economy in recession, and international visitor flows down to a trickle, the path to economic recovery in Otago is uncertain. The price increases required to fund Aurora's additional expenditure have come at a difficult time for Otago consumers.

We acknowledge that these estimated price rises are substantial for Aurora's customers and want to discuss our smoothing scenarios further with them during consultation on our draft decision.

Capital expenditure

Capital expenditure is recovered over the life of an asset, which in an electricity lines network is typically ranges from 25 to 70 years. Only a proportion of Aurora's capital expenditure will be recoverable during this CPP period, with the full impact becoming clearer when we set its next price path.

Aurora forecasts it would spend $356 million to replace ageing assets and invest in the growth of its network over the coming five years. Its customers and stakeholders generally accepted that some investment was necessary.

Our draft decision is to reduce this forecast expenditure by about $41 million (11%). This would allow $315 million.

Figure 11 Forecast capital expenditure

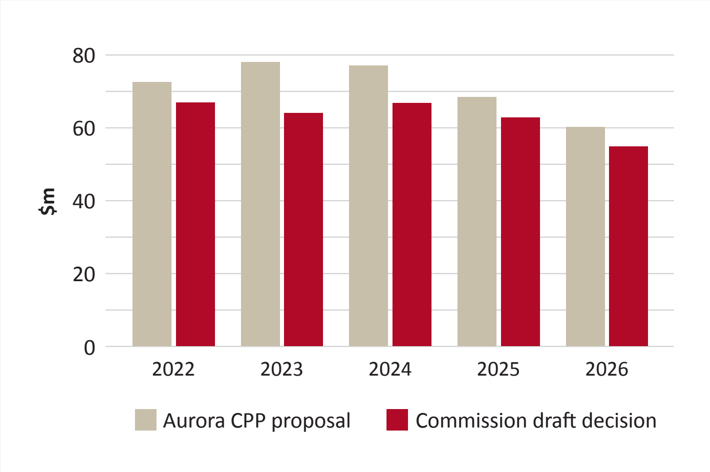


Table 4 below provides a breakdown of the capital expenditure proposed by Aurora compared to our draft decision by category.

Table 4 Capital expenditure breakdown

Expenditure category	Aurora proposal $m	Draft decision $m[2]
Asset renewals	281.8	258.4
Network growth and security	30.3	16.2
Other network capex	29.1	25.6
Non-network capex	15.2	15.2
TOTAL	356.3	315.5

Overall, we consider Aurora's has largely justified its capital spending proposal. The major reductions we have identified largely relate to growth and network security projects that we consider may not be needed, or can be deferred, due to the demand uncertainty stemming from COVID-19, along with some general efficiency savings.

2. Excludes capital contributions and any capex associated with Right of Use assets.

To address some of the unapproved spend we are proposing two reconsideration mechanisms that would allow Aurora flexibility to apply for additional expenditure if demand growth materialises during the CPP period. Aurora may apply to us to include approval of expenditure for:

- Work that is dependent on growth caused by increased demand or generation on Aurora's network; and
- Work that may be required due to risks relating to the condition of the network.

We consider this is an appropriate safeguard to prevent a lack of capacity on Aurora's network constraining economic recovery.

Operating expenditure

Aurora forecast it would need $253 million of operating expenditure, which would all be recovered from its customers over the five-year CPP period. It considered this funding would, among other things, primarily enable it to move from a reactive to proactive maintenance approach and improve its internal capabilities to implement its investment plan.

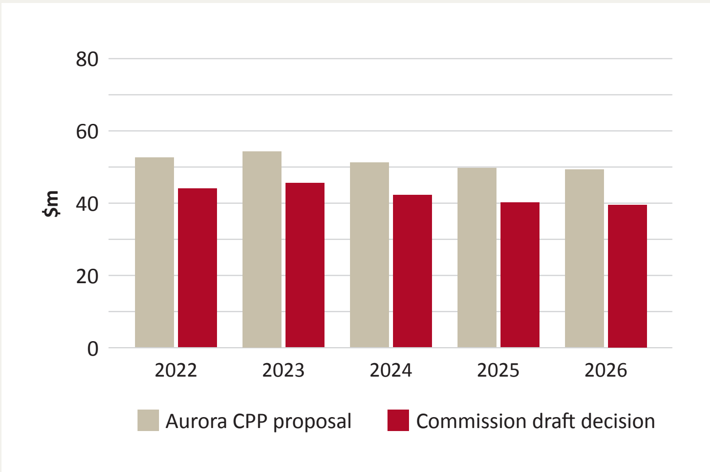
During consultation, stakeholders and consumers highlighted, among other things, staff and executive salaries, vegetation management practices and general capability concerns that they felt could affect Aurora's operating costs.

The Verifier reviewed 92% of Aurora's operating expenditure programme and highlighted several key issues it considered we should investigate further.

Our draft decision is that we should cut operating expenditure by $45 million and allow Aurora to spend $208 million of the $253 million it proposed – a reduction of 18%.

The draft annual operating expenditure allowance compared to what Aurora forecast is shown below.

Figure 12 Forecast operating expenditure



The breakdown of this spending is summarised as:

Table 5 Operating expenditure breakdown

Expenditure category	Aurora proposal $m	Draft decision $m[3]
Preventive, Corrective & Reactive Maintenance	70.3	69.4
Vegetation Management	21.2	16.1
System Operations and Network Support (SONS)	80.4	55.4
People costs	40.3	27.1
IT Opex	17.0	17.0
Premises, Plant and Insurance	5.1	5.1
Governance and Administration	15.6	14.5
DER Upper Clutha	3.0	3.0
TOTAL	252.9	207.7

Our draft spending reductions in operating expenditure reflect the fact that we do not consider all of Aurora's forecast spending was efficient or necessary for the size of its business. For example, on a relative basis, it planned to spend $11 million more than Powerco received under its CPP proposal on system operations and network support (**SONS**). This is despite Powerco having a network that is four and a half times longer than Aurora's, which would require higher staffing needs to operate.

We have also outlined spending reductions in Aurora's broader staffing levels and identified that the vegetation management unit rate appeared to be significantly higher than other lines companies.

We further consider that Aurora should become more efficient over time, which would lead to general cost savings across the CPP period.

Service quality and reliability

Power outages and voltage issues are a major inconvenience for consumers, particularly businesses. Aurora's customers told us that the quality and reliability of their supply were of significant concern to them. They did not necessarily want to pay more for improved reliability, but they also did not accept it should be allowed to deteriorate further.

Aurora requested we relax the quality standards it is currently subject to under its DPP to better reflect the state of its network. In its application, it forecast longer and more frequent unplanned outages compared to the 2016-2020 period and also expected planned outages to increase so that it can undertake network replacement.

3. From CPP Financial Model.

While Aurora asked us to amend its unplanned outage targets to more achievable levels, it has not sought a more lenient planned outage standard. This is partly because it expects it can significantly improve how it notifies its customers of planned outages so that it stays within its current standard.

In our view, the level of investment Aurora will be undertaking should enable it to perform better than it has proposed. Under our draft decision, Aurora would be subject to a package of quality measures we consider are realistically achievable given the current state of its network and provide incentives for it to improve the quality of its supply.

We have set draft unplanned outage targets at levels that broadly reflect Aurora's performance over the past five years. Aurora would face financial penalties if it misses the standards we set it, and rewards if it outperforms them.

We have accepted its proposal to maintain the standards that it currently faces for planned outages. We are satisfied it reflects the scale of work required to be undertaken on the network, while also incentivising Aurora to improve its notification of outages and minimise cancellations at short notice.

Overall, our draft decision would mean that Aurora's customers could expect the reliability and quality of their electricity supply to stabilise at today's levels, before gradually improving over time.

Accountability and delivery

A recurring theme of submissions on our Issues Paper package, and feedback received during public meetings, was that Aurora's customers do not trust it to deliver what it says it will. Aurora itself has acknowledged it has work to do to restore faith in its business and improve how it communicates with its communities.

With a work programme of this scale, a key risk is that priority maintenance and asset replacement is not undertaken quickly enough, which could affect the quality of supply for customers. Aurora has already taken steps to mitigate this risk and improve its ability to deliver, which are detailed in its CPP proposal and backed-up by the Verifier's report.

These steps include assessing its resource requirements and access to specialist technical services. It has brought on two additional providers – Unison and Connetics – to undertake field work alongside its subsidiary Delta and can call on other approved contractors for further labour resources as needed.

Internally, Aurora had also set up a Planning and Work Delivery design team for a 12-month period to June 2020 focused on creating and implementing the right processes to support project delivery.

Given these measures, our focus has turned to how we can best hold it accountable for delivering against its plan and improving performance in the longer term.

To provide us, customers and other interested parties with the information needed to assess its progress and performance over time, we are planning a series of wider measures to improve Aurora's accountability alongside the CPP draft decision.

To commence that process, we have set out our current thinking on the issues and how we plan to address them.

The new measures we are planning would require Aurora to:

- Produce an Annual Delivery Report (ADR), which will compare what it has delivered against what it said it would deliver broken down by individual region, and present it to customers in each of Aurora's three regions;
- Disclose information to customers annually on the quality of services (including monitoring and reporting by Aurora on voltage quality on its LV network), regional pricing and improvements in asset management, project quality assurance, data collection and quality, and cost estimation processes; and
- Procure, with our prior agreement, an independent expert report (during Year 3 of the CPP period) on progress in some of the more complex areas of the above requirements to provide us and stakeholders across its network with additional assurance that it is delivering benefits to its customers over time.

Aurora also has an existing consumer charter and compensation policy and plans to consult on potential improvements. We welcome the existence of these policies and think they can improve the relationship between lines companies and their customers.

We are proposing to require Aurora to publicly report on its performance against the existing commitments and how it has consulted with its customers on changes to its charter commitments and compensation scheme. We also propose to require Aurora to take action to ensure its customers are aware of the scheme.

We intend to release our draft decision on Aurora's information disclosure requirements for consultation at the same time as we publish our final CPP decision in March 2021.

We want to hear from you

We want to hear and consider the views of Aurora's customers and other stakeholders on our draft decision and its components. This will assist us make a final decision on Aurora's CPP and our proposed package of wider measures that promotes the long-term benefits of consumers.

To give us time to consider submissions and meet our statutory timeframes for setting Aurora's CPP, we ask that we receive emailed submissions by 10 December 2020 and cross submissions, following publication of responses on our website, by 23 December 2020.

We will consider all submissions received by these dates in reaching our final decision on Aurora's CPP.

Please email your submission to **feedbackauroraplan@comcom.govt.nz** with 'Aurora CPP draft decision' in the subject line of your email. All submissions will be published on our website, unless you indicate that your submission, or parts of it, are confidential.

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