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the lines company

18 December 2020

Commerce Commission
Regulation Branch
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Via email: feedbackauroraplan@comcom.govt.nz

Submission: Aurora Energy's proposal to customise its prices and quality standards – Draft decision

1. Introduction

1.1. The Lines Company Limited (TLC) thanks the Commerce Commission (Commission) for the opportunity to provide feedback on the Commission's draft decision, *Aurora Energy's proposal to customise its prices and quality standards*, 12 November 2020[1].

1.2. The draft decision relates to Aurora Energy Limited's (Aurora) application on 12 June 2020 for a customised price-quality path (CPP) to increase its regulated revenues to repair its electricity lines network and recover the cost of its spending from its customers.

1.3. Having reviewed Aurora's proposal, and assessed it against the framework and evaluation criteria set out in the rules and legislation that apply (which includes considering stakeholder views), the Commission accepts that the majority of Aurora's proposed investment is prudent and necessary to fix its network[2].

1.4. The draft decision differs from Aurora's proposal and the Commission's "*findings are materially different from the Verifier's conclusions in some parts but not in others*"[3].

2. Draft decision

2.1. The Commission details how the draft decision promotes the long term benefit to consumers:

- Safety issues addressed;
- Reliability performance stabilised with incentives to improve, and sanctions if performance deteriorates;
- Improved notification of outages;
- Ensuring Aurora spends the right amount at the right time;
- Aurora has incentives to improve efficiency over time;

[1] https://comcom.govt.nz/regulated-industries/electricity-lines/projects/our-assessment-of-aurora-energys-investment-plan?target=documents&root=215975
[2] Aurora Energy's proposal to customise its prices and quality standards – Draft decision X54, page 16.
[3] Aurora Energy's proposal to customise its prices and quality standards – Draft decision X35, page 12.

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- Smaller price increases than Aurora proposed;
- Innovation encouraged;
- Incentives to improve performance over time.

2.2. The draft decision has reduced Aurora's forecasts of capital expenditure by about $40.9m (11.5%) and operating expenditure by $45.3m (17.9%).

2.3. The reduction in operating expenditure in the draft decision is less than the estimate of what Aurora's Opex allowance would be under the default price-quality path.

2.4. The reduction in Opex includes:

- System Operations, Network Support and People expenditure has been significantly reduced to reflect the efficient costs that would be required by a prudent electricity lines company;
- people expenditure reduced due to a smaller increase allowed for staff training costs than proposed by Aurora;
- reduction to Governance and Administration opex proposed due to efficiency benefits from bringing in-house a material amount of its legal work.

2.5. The draft decision states that Aurora should become more efficient over time, which would lead to general cost savings across the CPP period.[4]

2.6. TLC is of the view that Aurora should be given time to realise any efficiency gains over the medium to longer term – focusing first on safety and reliability.

2.7. TLC is cognisant that distribution networks across New Zealand are vastly different and it can be misleading to compare or benchmark distributors for many reasons. TLC notes that the Commission may not, for the purposes of section 53P (Resetting starting prices, rates of change, and quality standards), use comparative benchmarking on efficiency to set starting prices, rates of change, quality standards, or incentives to improve quality of supply[5].

2.8. Aurora's CPP application involved an 'on-the-ground' Verifier over 12 months who completed a bottom-up review of forecasts.

2.9. TLC is of the view that this on-the-ground analysis should be relied upon unless there are exceptional reasons to deviate.

3. CPP process

3.1. Determining a CPP is the Commission's decision, so the Commission relies on its own judgment in applying the evaluation criteria. This involves the Commission promoting the long term benefits of consumers by balancing the section 52A matters of the Commerce Act 1986 that the Commission is required to give regard to:

- incentives to innovate and to invest, including in replacement, upgraded, and new assets; and
- incentives to improve efficiency and provide services at a quality that reflects consumer demands; and

[4] Aurora Energy's proposal to customise its prices and quality standards – Draft decision X98, page 27.
[5] Section 53P(10) of the Commerce Act 1986.

- shares with consumers the benefits of efficiency gains in the supply of the regulated goods or services, including through lower prices; and
- is limited in its ability to extract excessive profits.

3.2. TLC's concern is that some of the judgements may be subjective due to complexities, known and unknown.

3.3. As the Commission states, the input methodologies (IMs) underpin the price-quality paths and information disclosure requirements that regulated suppliers are subject to under Part 4 and have the purpose of *promoting certainty for suppliers and consumers about the rules, requirements, and processes applying to regulation or proposed regulation*. The Commission's focus in setting the IMs is to increase certainty by maintaining regulations that are stable, provide suppliers with incentives to invest in long-lived infrastructure and deliver long-term benefits to New Zealanders[6].

3.4. A subjective approach could create uncertainty for future CPP proposals and undermine the regime, and result in stakeholders and community losing trust and confidence in the CPP process amongst other things.

4. Community and stakeholder engagement

4.1. TLC is aware of the importance of engagement with the community and other stakeholders. We are also aware that to obtain the true sense of the feeling in the community is difficult and hard work.

4.2. Customers can avoid engagement because of the complexities of the industry meaning that traditional engagement methods require modification – traditional engagement methods run the real risk of being hijacked by lobbyists, and a vocal minority.

4.3. TLC's experience has taught us that people who are happy with their service (or even ambivalent) won't necessarily engage in consultation and provide that feedback. Hence, care needs to be taken when considering feedback.

5. Affordability

5.1. The draft decision discusses affordability and energy poverty, albeit briefly due to the Commission's limited powers in these areas under the Commerce Act.

5.2. Submitters told the Commission that the proposed price rises would impose financial stress on many of Aurora's customers and this 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).

5.3. TLC has been a strong advocate of supporting vulnerable customers and tackling energy hardship – a customer-focused approach is imperative. Affordability is an issue, however, that TLC considers is a New Zealand issue and is not limited to the electricity industry. This means that a holistic view and discussion is required about affordability.

[6] https://comcom.govt.nz/regulated-industries/input-methodologies/overview-of-input-methodologies

5.4. TLC notes that the customers highlighted by the Commission in the draft decision are recipients of the winter energy payment which is designed to assist customers paying their energy bill. TLC encourages the continuation of this scheme but for it be more targeted – a viewpoint TLC provided to the Electricity Price Review consultation.

6. Smooth revenues to limit price shock

6.1. As part of the Commission's CPP decision, the Commission has sought to reduce the shock of large price increases to Aurora's consumers by smoothing the amount of revenue Aurora can recover over time.

6.2. The Commission considered various options and is proposing to limit the increase in Aurora's total revenues to approximately 10% per annum, inclusive of inflation.

6.3. The Commission has also implemented a +10% limit on the annual increase in a distributor's gross 'forecast revenue from prices' (revenue including pass-through and recoverable costs).[7] The Commission says the limit works in a present value-neutral way, with any under-recovery of revenue deferred to subsequent years of the DPP (or until the next DPP) via the wash-up mechanism.[8]

6.4. The Commission states that setting the limit was a judgement call[9].

6.5. The Commission did not adopt Orion's, Wellington Electricity's and Vector's submissions that the limit on the percentage annual increase in forecast revenue from prices be applied to only the distributor's costs and not to the component of revenues related to the recovery of pass-through and recoverable costs[10].

6.6. These costs can have a material impact on changes in the total or 'gross' revenue distributors collect: pass-through costs are costs that distributors have almost no ability to control; recoverable costs are costs which distributors may have some limited ability to control.

6.7. TLC believes that this limit could be reconsidered especially considering that pass-through and recoverable costs are largely outside of a distributors control, and it is up to electricity retailers to determine the final prices that customers will pay for most distributors and their customers.

7. Conclusion

7.1. TLC acknowledges the work and effort that all parties have input into this process to date and we trust that the learnings and outcome will be for the long term benefit of consumers.

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[7] Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision Reasons paper, 27 November 2019, 6.23.
[8] Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision Reasons paper, 27 November 2019, 6.24.
[9] Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision Reasons paper, 27 November 2019, H53.
[10] Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision Reasons paper, 27 November 2019, H63.

7.2. TLC also acknowledges that this issue is controversial given the history and trying to obtain a balance between the services that consumers demand now and into the future and what consumers are prepared to pay is difficult. However, safe and reliable infrastructure is the goal for all parties.

7.3. TLC trusts our contribution to this process adds value and is happy to discuss any matters we have raised in our submission.

Yours sincerely

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Pricing Manager