

Commerce Commission
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Dear Commission

UNISON SUBMISSION ON AURORA CPP APPLICATION – DRAFT DECISION

This letter constitutes Unison’s submission on the Commission’s draft decision on Aurora’s CPP application. We would not ordinarily comment on another EDB’s CPP application given the highly detailed matters involved that are situation specific. However, given the substantial difference in what Aurora had applied for and what the Commission proposes to provide for in the revenue allowances we felt it important to understand the basis for the variance and offer our views where they may be useful to the Commission’s decision-making.

As we understand the situation confronting Aurora:

1. Under previous governance and management Aurora had not kept up with inspection, maintenance and investment in the network, causing a significant deterioration in asset condition leading to safety risks and poor reliability outcomes – significant investment is required to bring the network up to an appropriate level;
2. On top of poor asset condition, Aurora’s management systems and data quality were/are in a similarly poor or immature state, which is requiring Aurora to make significant investments in bringing its asset management capability to that expected of an organisation that needs to achieve modern standards of best-practice asset management;
3. Unison Contracting Services (Unison Networks’ contracting subsidiary) is a key partner and service provider to Aurora in helping it to modernise its network. It has experienced first-hand the challenges facing Aurora as its systems have struggled to cope with a high volume of works to be delivered, with disruptions to the pipeline of work as different bottlenecks have needed to be addressed. Aurora’s systems have improved significantly, but significant work remains;
4. Aurora applied for a capex allowance of \$356m (five years) and opex allowance of \$253m (five years). We understand that these allowances were scrutinised by the independent verifier over an approximately 12 month period, with significant interactions between Aurora and the verifier to ascertain the proposed allowances’ consistency with the “expenditure objective”.

5. In the Commission's draft decision, it proposes to:
 - a. reject Aurora's request for a three year CPP;
 - b. to allow capex of \$315m (-11.5%) over the regulatory period; and
 - c. to allow opex of \$208m (-18%) over the regulatory period.

6. We understand that the Commission's proposed allowances were largely based on a desktop review by Strata Energy Consulting.

Unison found it particularly striking that the Commission rejected Aurora's three-year application and rejected 18% of Aurora's opex allowance. We have focussed attention on the basis for these draft decisions. In respect of both issues, Unison offers its views from the perspective of an organisation that has invested significantly in developing its asset management capability over an extended period of time, with that investment culminating in certification to the ISO55001 Standard for Asset Management Systems. We would hasten to emphasize that certification is not an end-point, but a marker that asset management maturity has reached a sufficient state to obtain certification, with an expectation that the asset management system would continue to evolve (which is a requirement of ISO55001).

As we understand Strata's approach, they undertook a three-step process:

1. A desktop "senior management challenge" of the additional roles that Aurora has established since separation from Delta and what Aurora considers is required to mature its asset management capability;
2. An assessment of Aurora's proposals against a subset of NZ EDBs considered industry peers; and
3. A comparison with Powerco's SONS opex.

We offer the following comments:

1. Strata states with respect to its "senior management challenge":

"Drawing on our collective management experience in the electricity sector over many years, Strata undertook a top-down challenge of Aurora's proposed increase in roles. We concluded that Aurora's uplift in roles could be reduced by some 30–50%. Table 4 summarises our findings.

There is an information asymmetry between Strata and Aurora's ELT and Board, meaning we are not as informed. However, this is the sort of challenge we would expect to see from these parties.

The number of roles we have estimated following the challenge session are for the start of the CPP period. Over the course of the CPP and review periods, we expect that several roles will no longer be needed as a result of transitional activities ending (e.g. development of standalone Aurora policies following Aurora's separation from Delta; establishing new processes for data, communications and information management). We expect the cessation of these roles to occur over years 3–5 of the CPP period, although some roles could cease earlier in year 2 of the CPP period. As noted above, Aurora will have been a standalone entity for almost five years when the CPP begins..."

Unison makes the following observations:

- A genuine “senior management challenge” would have involved Strata engaging with Aurora senior management to undertake a detailed evaluation of Aurora’s organisational structure and the specific outcomes to be delivered by existing and new roles, especially in a context of the management systems and processes within Aurora that require modernisation. We note that in an organisation that is delivering a step change in network opex and capex there is substantial challenge in using business as usual processes to deliver a works programme, let alone make time to create the business processes and documentation required to achieve the capabilities required to meet the ISO55001 standard. Unison submits that the Commission should be very wary to accept what appears to be a superficial set of judgments about the headcount required to manage Aurora’s business without a detailed understanding of the business.
 - When considering Aurora’s proposed FTE level, given the context of its CPP and what it seeks to deliver on the network in comparison to Unison’s own headcount, we are somewhat surprised that Aurora is not in fact seeking a greater allowance for a period to enable it to build asset management capability, especially when considering the historical low level of expenditure prior to 2017.
 - In our view, it would seem highly likely that if Aurora were required (or sought) to reduce to the level of headcount suggested by Strata it will not be able to deliver its works programme or improve its asset management capability.
2. With respect to benchmarking against other EDBs, again we suggest that the Commission should be wary of making cuts to proposed expenditure based on benchmarking results, especially those comparisons that rely on costs per ICP or costs per km of lines. Specifically:
- In the past we have sought to benchmark our own Business Support and System Operations and Network Support opex against other EDBs. Due to categorisation/definitional issues and business model and structure variances between EDBs this is a highly fraught exercise. We recommend that the Commission avoid comparisons based on separate comparisons of business support and SONS expenditure and combine these categories for any comparison purposes;
 - Business Support and SONS costs are only weakly driven by scale of network (ICP count or km of network). We would expect that if Aurora’s network was 20-30% bigger or smaller (in either dimension of number of km or ICPs) there would not be the same proportionate change in business support and SONS costs. There are significant degrees of fixed costs that will not vary materially with network size, or perhaps only in steps. Unison submits that the Commission should place little weight on costs per ICP or costs per km comparisons.¹

¹ This has been a consistent critique of the Commission’s approach to growth in expenditure allowances under DPP resets. There is significant unexplained variation in the non-network opex costs between networks that is not accounted for by numbers of ICPs and km of network.

Accordingly, although the comparisons on pages 132-134 of Strata's report appear to show Aurora as an outlier, they provide a misleading basis for comparison.

- Given the context of Aurora's application where there is a significant step-up in expenditure on the network, and a requirement to improve asset management maturity, in our view a much better indicator of relative expenditure comparisons between networks is non-network expenditure as a proportion of totex. In that respect the charts on page 137 of Strata's report provide an indication that Aurora's non-network opex proposals are not unreasonable:

Figure 12: SONS / totex

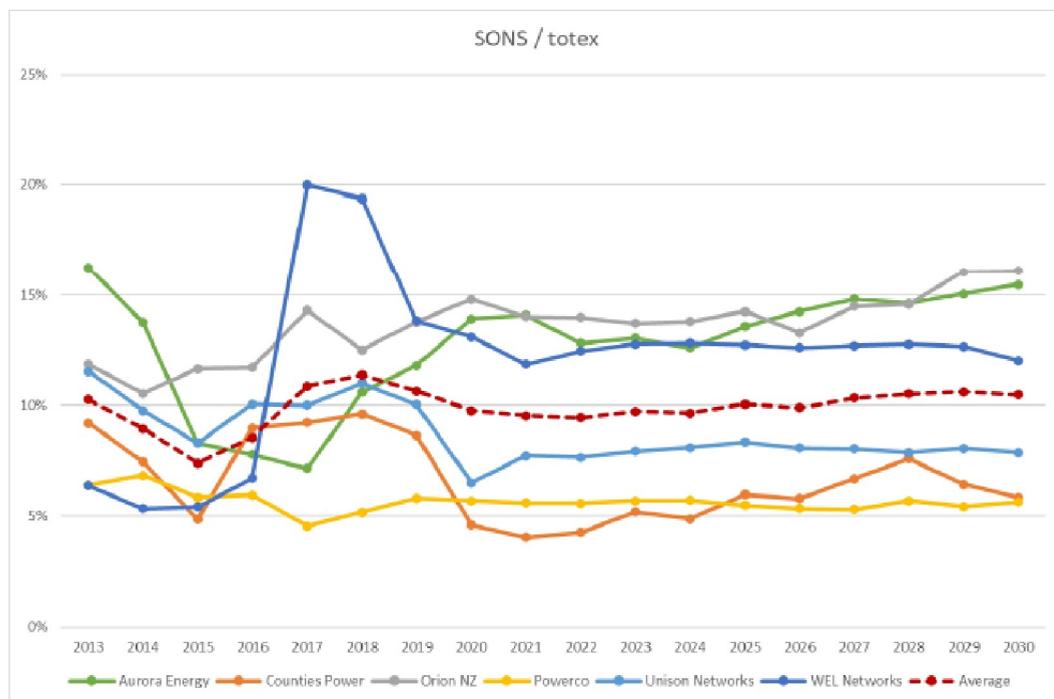
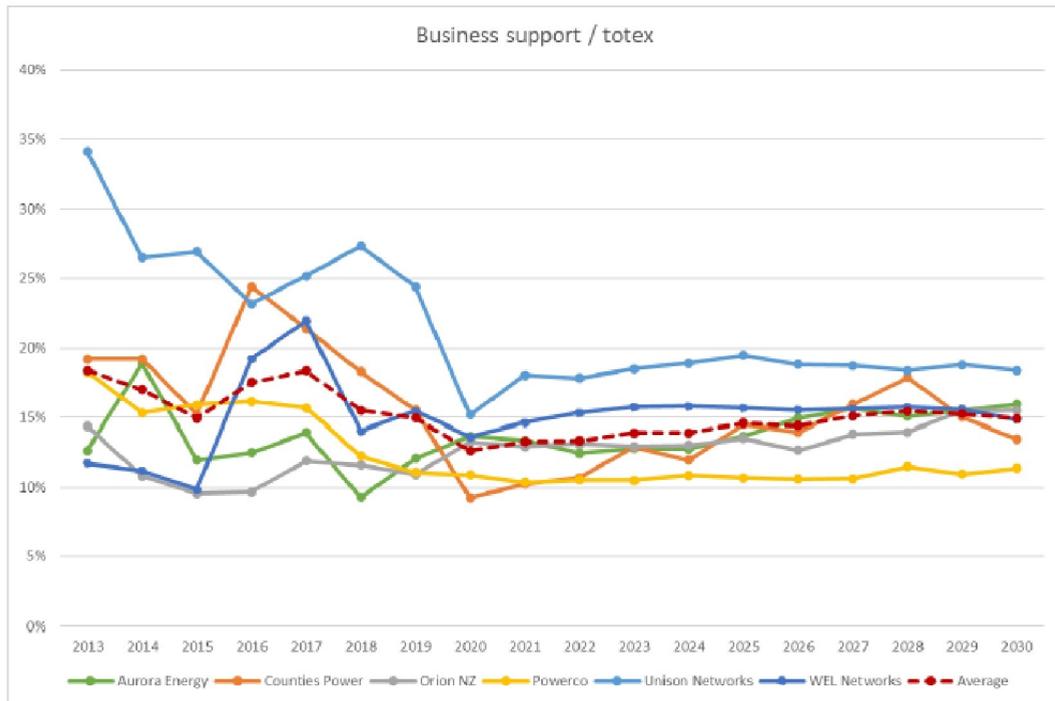


Figure 13: Business support / totex



- Similar to our comments on the benchmarking analysis, Unison submits that the Commission should be wary in accepting Strata’s comparisons with Powerco’s expenditure levels during its CPP. As we note above network scale is only a weak driver of many non-network operating expenditure requirements, but we also observe that Powerco spent many years preparing its CPP application and had more time to develop at least some of its asset management systems to support its CPP application. Aurora’s starting position would appear to be a long way behind.

Overall, we strongly question the appropriateness of the Commission relying on desktop reviews conducted by Strata to make multi-million dollar decisions that will significantly impact on Aurora’s ability to deliver its CPP works programme. While we have no doubt that Aurora will respond comprehensively to the Commission’s draft decision with evidence to support its position, we must admit to finding it particularly worrying that the Commission has erred on the side of desktop-based analysis than the verified application. The size of the Commission’s proposed adjustments would beg the question of the value of the verification process, and if extended to the final decision, in our view would likely undermine confidence in the CPP process.

We hope that the Commission finds these comments helpful in reaching its final decision.

Yours sincerely,

Nathan Strong
GENERAL MANAGER COMMERCIAL