MAJOR ELECTRICITY USERS' GROUP

19 January 2018

Dane Gunnell
Senior Analyst, Regulation Branch
Commerce Commission
By email to powercocpp@comcom.govt.nz

Dear Dane

Powerco CPP draft decision – cross submission

1. This is a cross-submission by the Major Electricity Users' Group (MEUG) on the submissions of 10 other parties to the Commerce Commission draft decision "Powerco's proposal to customise its prices and quality standards", 16 November 2017 (the Powerco CPP draft decision).[1]
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.
3. This cross-submission has 10-section headings:
    - Heightened interest by consumers in this CPP application and pending decision;
    - The draft decision is wrong to increase quality standards and impose higher costs on consumers as that does not match consumer preferences;
    - The Commission's decision-making has erred from best practice and possibly the requirements of the Act in failing to undertake a cost-benefit-analysis;
    - The Annual Delivery Report;
    - Early disclosure of information on options;
    - Deferred capex renewals;
    - A range of demand scenarios is needed;
    - Tauranga area and Whangamata projects and reactive maintenance need to be reviewed;
    - Concerns on quality of PODs and OAEETs and why sum of those net benefits is not equivalent to an estimate of the net benefit for the application as a whole; and
    - The Network evolution proposal.

[1] http://comcom.govt.nz/regulated-industries/electricity/cpp/cpp-proposals-and-decisions/powercocpp/powerco-customised-price-quality-path-draft-decision/

Heightened interest by consumers in this CPP application and pending decision

4. Seven of the eleven submissions were from customers or consumer groups and the eighth from a retailer, Contact Energy, acting as an agent for consumers.[2] The remaining three submissions comprised:

   - One from an independent expert, Pat Duignan. The submission by Mr Duignan, an ex-Commissioner with the Commerce Commission, is important because of his expertise and experience; and
   - Two from Electricity Distribution Businesses (EDB); the applicant Powerco and a potential CPP applicant Aurora Energy.

   This is probably the highest proportion of consumer feedback on any Part 4 of the Commerce Act consultation ever.

5. The heightened interest by consumer groups is a desirable outcome as improving customer participation is an important policy objective. On the other hand, the reason for the heightened interest appears to be concerns at the decisions proposed in the draft decision. For example:

   - The treatment of who should pay for deferred capex renewals raises important policy issues; and
   - Why should customers of monopoly services provided by Powerco pay more for higher quality when:
     - ~ Customers do not want to pay for higher quality? and
     - ~ NZIER's initial view is that the customer value of the incremental benefit[3] of higher quality than the status quo is less than the incremental cost for the 10-year period covered by the Powerco CPP forecasts.

The draft decision is wrong to increase quality standards and impose higher costs on consumers as that does not match consumer preferences

6. MEUG submitted the Commission should scale back targeted quality standards to the status quo and consequently potentially approved expenditure can be scaled back.[4] Pat Duignan submitted on this topic in detail. He affirmed our view Powerco consumers prefer quality to be maintained and an aversion to higher quality if that incurs higher costs.[5]

7. Mr Duignan submitted:[6]

   > "The Commission's process for evaluating CPP proposals requires a decision on "*appropriate service standards*" and in the case of a proposal for higher expenditure to maintain or increase reliability that decision needs to be based on a comparison of cost versus benefits. Information limitations do not remove the need for such a decision.
   >
   > The Commission is creating a precedent that, in response to an expenditure proposal that the Verifier and Commission judge increases rather than maintains reliability, when surveys indicate that customers do not want to pay for increased reliability, the Commission will test the technical efficiency of the expenditure and then define the quality standards that result from the proposal as appropriate service standards."

[2] The count of 11-submitters assumes the report by NZIER for MEUG and Allan Miller Consulting for Powerco are treated as part of the submissions of those parties and not separate submitters.
[3] The benefit is calculated as the described estimated value of lost load avoided, a similar approach to that used by Powerco in its analysis of the major projects as Options Analysis and Economic Evaluation Tool (OAEET).
[4] MEUG submission, paragraphs 6 to 11.
[5] Pat Duignan submission, paragraphs 2 to 8.
[6] Ibid, paragraph 9.

8. The submissions of Mr Duignan have reinforced and strengthened our views on this issue. We submit the Commission is wrong to increase quality standards and therefore impose higher than desired costs on consumers as that does not match consumer preferences. Corollary points to our view are:

   - If the draft decision stands it will potentially create uncertainty for future CPP applications for all parties on the relevance of surveys conducted to uncover consumer preferences. This risk is demonstrated in the draft decision for this application where the outcome is:

     ~ contrary to the response of customers; and

     ~ the draft decision has no robust model or quantified analysis supporting an increase in quality.

     On the latter point NZIER's initial view was that the customer value of the incremental benefit of higher quality than the status quo is less than the incremental cost for the 10 year period covered by the Powerco CPP forecasts.[7] NZIER maintained this view after re-estimating the net benefit to increase the consumer and business value per kWh of lost load by 2 percent per year (in response to Commission comments) and after adjusting for the reduced unplanned SAIDI targets set by the Commission (which increase the value of avoided unplanned outages).[8]

     On the former point, if consumers perceive their voice is not being listened too that will act as a disincentive for future consumer participation.

   - We see no reason why the Commission cannot use methods to decrease the CPP revenue cap other than just relying on juggling the discrete forecast capex proposals and opex costs in the application. Where a detailed bottom up estimation of costs over a 5-year CPP do not allow precise scaling for different levels of quality then a method to scale costs to match desired quality should be used.

     We do not understand why scaling has not been considered when the final determination is for an annual revenue cap with no requirement for delivery of specific projects or opex in the application or referenced in the decision material supporting the determination. Once the final determination is made, it is up to Powerco how to best utilise resources given the aggregate revenue cap and quality standards.

The Commission's decision-making has erred from best practice and possibly the requirements of the Act in failing to undertake a cost-benefit-analysis

9. MEUG submitted a rebuttal to the view in the draft decision that a CBA was not needed to compare the application against alternative price-quality path options. An expert report by NZIER responding to the views of the Commission on the need for a CBA was part of our submissions.[9]

10. The submission by Pat Duignan comprehensively canvases the legislative and best public policy practices of when and how to conduct CBA for economic regulation and for Part 4 of the Commerce Act including consideration of CPP applications.

[7] The analysis supporting the comparison of the benefits and costs over the period covered by the Powerco CPP forecasts 2018 to 2027 is explained in NZIER, Submission on Powerco CPP Issues paper, 22 September 2017, Section 1.2 pages 1 to 5.
[8] NZIER's response to the Commission critique of the comparison of costs and benefits over the period covered by the Powerco CPP forecasts (2018 to 2027) is explained in NZIER Submission on Powerco CPP draft decision, 15 December 2017, Section 3 pages 10 to 11.
[9] MEUG submission, paragraph 9, and NZIER report to MEUG, pp10-11.

Given the experience of Mr Duignan, the points in his submission should be a key foundation for the final determination. To paraphrase some the points by Mr Duignan:

- The Commission must decide on "appropriate service standards" and if it is deciding to improve reliability it needs to compare the cost and benefit of the increased reliability.
- The Commission's Powerco decision creates a precedent of using the proposal to define appropriate quality standards delivering increased reliability when surveys indicate that customers do not want to pay for increased reliability.
- The draft decision's central justification for overriding the expressed consumer preference - "needs to be supported by a cost-benefit analysis comparing that value with the cost".
- Undertaking cost-benefit analysis in the way proposed is not introducing a new evaluation criterion. It is just using a standard tool to quantitatively assess the net benefit to consumers.
- Cost-benefit analysis is not a special methodology that would be appropriate only if detailed in the input methodologies.
- The Commission cannot be sure that the Powerco CPP draft decision is in the long-term interest of consumers, without undertaking a cost-benefit analysis.
- The Commission should analyse the reliability-cost trade off in deciding this and similar CPP proposals. This would be consistent with the concept of DPP-CPP regulation. A CPP decision is the only opportunity to consider this key trade-off issue.

11. Aurora Energy supported the draft decision that a CBA was not required.[10] Aurora made several points.

- Aurora – "Quantified CBA can play an important role in decision-making."[11]

  MEUG view – The caveat of "can" in the above quote leaves us uncertain if Aurora have a view on circumstances when a CBA is important or not, or necessary or not. It would be useful to understand what cataloguing Aurora have in mind because we do not see any other option than to use a CBA as discussed in the next bullet-point. We would therefore substitute "must" for "can" in the above quote.

- Aurora (paraphrased) - Input Methodologies (IM) do not require a CBA for CPP and therefore MEUG and others should have suggested this change in the last review of IM.[12]

  MEUG view – IM may not explicitly state precise CBA mechanics but it is inconceivable how, other than by an ad hoc approach and luck, that a CPP final determination will be the best of all feasible options for the long-term benefit of consumers. Therefore, implicitly a CBA is necessary. This view is supported Pat Duignan's submission which argues that:

  ~ CBA is a tool that is appropriate for the Commission's assessment of the net benefit of the CPP to consumers and is not a separate evaluation methodology that needs to be specified in the input methodologies.

  ~ The Commission cannot be sure that the Powerco CPP draft decision is in the long-term interest of consumers, without undertaking a cost-benefit analysis.

[10] Aurora Energy submission, section 5, p3.
[11] Ibid, section 5, paragraph 4, first sentence.
[12] Ibid, section 5, paragraphs 2 and 3.

- Aurora (paraphrased) – Cannot allow a 'mid-play changing of the rules of the game' by determining the CPP application using CBA after the application has been made.[13]

  MEUG view – As noted above we cannot see how a robust and defensible determination can be made without a CBA. Aurora submit a mid-play changing of the rules would be contrary to the regulatory certainty principle underpinning the IMs. We think Aurora is referring to the regulatory certainty objective for IM and note that is subsidiary to the overall Part 4 objectives.

  If you apply the Part 4 objectives we do not see how the long-term benefit of electricity customers supplied lines services by Powerco will achieve the best ex ante set price-quality pairing without a CBA approach. Regulatory certainty may be a material factor in a broader CBA for precedent effects for future CPP applications; but that cuts both ways. Powerco may feel aggrieved with the Commission applying a CBA but should the Commission fail to do so, then consumer confidence in the CPP process and the Part 4 regime is at risk of being undermined.

- Aurora – "It is disappointing that the CBA provided by NZIER was of such a poor quality, and excluded substantive categories of benefits. Aurora Energy agrees with the Commission that, regardless of whether quantified CBA should be part of the relevant criteria for a CPP, the NZIER CBA is not fit-for-purpose and, if it is corrected for the most obvious and egregious errors, the NZIER CBA can actually provide support for Powerco's CPP proposal."[14]

  MEUG view – Aurora's comments presumably stem from the first NZIER report of 22 September 2017 submitted as part of MEUG's response to the Commission's "Issues to Explore and Consider" paper of 18 August 2017 and the draft decision of 16 November 2017. We asked NZIER to provide a CBA framework that the Commission should use and proposed that in our earlier submission in September. We have never claimed the NZIER CBA was comprehensive.

  Aurora's submission refers to our CBA framework as being "poor quality", "excluded substantive categories of benefits" and claims "if it is corrected for most obvious and egregious errors, the NZIER CBA can actually provide support for Powerco's CPP proposal." Without evidence or cross-references from other source material to support those statements, MEUG recommend the Commission ignore those submissions.

  Moreover, Aurora's submission that an amended NZIER CBA could support the Powerco CPP proposal reinforces MEUG's point. If a robust CBA supported the proposal that would provide a welcome evidence base for consumers to support the Commission's decision-making. MEUG's issue is that that evidence base is currently lacking and should form part of the Commission's final decision-making.

The Annual Delivery Report[15]

12. Powerco submitted on several details of the Annual Delivery Report proposed by the Commission.[16] The submissions by Powerco reinforced with us the view that this is not a trivial exercise. We don't think it is productive for the Commission to put resources into fine tuning the Commission's expectations of what might be in the Annual Delivery Report before the final determination date when resources should be deployed undertaking a CBA.

[13] Ibid, section 5, paragraph 3.
[14] Ibid, section 5, paragraph 5.
[15] Previously the Annual Delivery Report had been termed the Annual Planning Report (ARP).
[16] Powerco submission, paragraphs 28-39. Powerco refer to

13. Contact Energy submitted in detail on options for external consultation for third party providers of alternatives to traditional lines and wires solutions. In that context Contact Energy were not supportive of the Powerco led Annual Delivery Report.[17] MEUG has a different view, at this stage, to Contact Energy on the relationship between regulated EDB services and third-party providers.[18] Setting this aside, we agree with the risks with the Annual Delivery Report in Contact Energy's submission:[19]

> "Looking to an industry-driven, passive 'after the event' self-assessment process is not the kind of regulation that is needed to incentivise certain behaviours."
>
> "It [the Annual Delivery Report] would impose costs on networks for no apparent purpose in preparing documents that would be of no practical use to anyone."

14. A solution for reducing these risks is to require and specify how and with which parties Powerco should consult on the design of an Annual Delivery Report. Those parties should also have the back-stop of asking the Commission to intercede should agreement not be possible with Powerco; otherwise interested parties will have no countervailing power to Powerco and participation in the process will languish. Fonterra mention this aspect in their submission:[20]

> "The APR document looks like a step in the right direction but there is no way to ensure customer feedback is taken on board to drive improvement in the following years. Fonterra recommends that CC consider how such an improvement could be incorporated."

Early disclosure of information on options

15. Since submissions on the draft decision closed, MEUG has lodged a submission on the Transpower Capex IM draft decision. In that submission, we recommended Project Overview Documents (PODs) and Options Analysis and Economic Evaluation Tools (OAETTs) as tabled by Powerco in their CPP application or similar be published by Transpower. We noted:[21]

> "The one failing in that CPP process was the PODs and OAEETs were not published sooner"

We recommend the timing such information is made available to interested parties should be part of the post-decision review.

Deferred capex renewals

16. There was one key topic in the submissions of other parties that needs to be considered as a post-decision review topic, if not actionable by the Commission in its final determination. That topic is who should pay for deferred capex renewals? Four consumers made submissions on this question:

- Allen Davies:

> "If Powerco have failed to keep their network up to date and fit for purpose at all times they should not now be imposing increased costs onto the consumers to catch up while more than likely still paying dividends to their shareholders …

[17] Contact Energy submission, paragraph 4.15 and 4.16.
[18] MEUG is adopting a wait and see approach on how the just published changes to IM and Information Disclosures for related party transactions. Simultaneous to observing actual experience with the new IM and ID settings we will be monitoring and engaging with various EA workstreams including the work of the Innovation and Participation Advisory Group (IPAG) and the soon to commence MBIE review of electricity pricing that, in the draft terms of reference, includes policy settings related to third party provision of alternatives to traditional poles and wires.
[19] Ibid paragraph 4.16, bullet points.
[20] Fonterra submission, paragraph 5.1.
[21] MEUG to CC, cross-submission on draft Transpower capex IM decision, 16 January 2017, paragraph 7, bullet point 1].

> It is now the Commerce Commissions responsibility to see that Powerco get their network up to scratch, but at the same time to not penalise their consumers of today for their past lack of future proofing of their network."

- Grey Power:

> "… as noted by the independent assessor,
>
> "increased capex and opex [sought] is required to stabilise asset performance through addressing a rising number of asset defects as assets wear out and to support good practice asset management such as on systems to provide better quality information and analysis, which are expected to reduce expenditure needs in the longer term "They then further note that "…Powerco intends to implement good asset management practices." (my emphasis).
>
> We can only conclude that PowerCo does not currently, and has not in the past, effectively managed their assets in a manner that a prudent and efficient organisation in a competitive market place would be expected to do, in order to avoid the situation that PowerCo now finds itself in. An analysis that we note the Commission shares when it states that "current activities and expenditure is arguably below that associated with prudent practice".
>
> From this we can only assume that PowerCo has deliberately avoided both OPEX and CAPEX expenditure on maintaining assets in order to bolster or maintain shareholder returns.
>
> We submit that to allow the current expenditure now required to be recovered from consumers is contrary to the long term benefit of consumers since it does not reflect the reality that would occur in a competitive market place, and effectively encourages poor management practice in the expectation of a bail out from the public purse in order to meet its obligations."

- Kamada Developments:

> "There now seems little doubt many of the network assets are in a run-down state and need urgent attention. What has not been addressed by the Commission is why this is the case and how this has reflected financially for PowerCo. Have PowerCo shareholders been advantaged financially through insufficient maintenance in past years? Did PowerCo purchase run-down assets at a reduced price and now need catch-up maintenance?
>
> The fact network assets are in the condition described is surely an indictment on the Board and management of the day. Questions also arise as to the regulatory regime that has not previously identified the problems PowerCo themselves now seek additional funding to rectify.
>
> These points lead back to our previous question as to why consumers should shoulder these increased costs? Corrective work is obviously required and this cost should be borne by the shareholders not by consumers.
>
> We do not support the Commission's decision to allow increased revenue for PowerCo. Rather the quality monitoring regime should require the remedial work identified to be undertaken urgently at the cost of PowerCo shareholders."

- Terry Wilson:

> "… the company, while producing healthy profits and large dividends for many years, has suddenly discovered that it has, over those many years, been neglecting to adequately fund the renewals of its equipment. As with Aurora Energy, Powerco has had the choice of pleasing its shareholders or sustainably funding equipment renewals.
>
> These decisions to divert cash from renewals to dividends may have been made on assumption that you would grant their application for a CPP. If you grant this application other companies will become aware of your feckless decision-making and assume that they can behave in same way as Powerco and Aurora by neglecting their renewals as a way of bypassing the DPP. Any company that pays a dividend should not complain that they can't afford to pay for their renewals capex and they certainly should not expect the Commerce Commission to ensure that they can continue to pay a healthy dividend.
>
> This application from Powerco and the one expected from Aurora are symptoms of the failure of the Commerce Commission to properly monitor the adequacy of renewals capex. You should have been aware of these growing problems over a long period. You need to get this fixed."

17. The Commission may consider that prior checks on profitability of EDB has set aside any concerns on excess profits to date and a clear line can be drawn excluding consideration of prior profits in deciding who should pay for deferred capex renewal. Therefore, the Commission, and some distributors, may conclude in all cases its customers that must pay for future deferred capex renewal. We disagree that the evidence is clear cut, or at least prior analysis of EDB profitability and the robustness of the regulatory valuation of assets has taken into account the material risks of undeclared or unknown deferred capex renewals. The submissions quoted above illustrate the depth of customer concern on this issue.

A range of demand scenarios is needed

18. MEUG suggests a new topic for the post-decision review is clarity, transparency and consistency of demand forecasts used by CPP applicants. The importance of demand assumptions and the scenario where demand may materially decrease was noted by Grey Power:[22]

> "… we would query the basis of these objectives, in particular the assumptions of growth in distribution capacity. We consider on the basis of available evidence that the evolution of microgrids and the continuing exponential fall in the cost of battery storage, that distribution networks' need to over build for peak capacity (spikes) will reduce drastically within the lifespan of the proposed CPP."

19. The submission from Molly Melhuish provided evidence of international experience and views supporting the scenario that demand for traditional lines services may decrease due to rapid early uptake of non-line alternatives:[23]

[22] Grey Power submission, p1, paragraph 4.
[23] Molly Melhuish submission, p1, paragraph 6.

> "The expected "likely … second and more material price increase, driven by the capex spend during the CPP period, in the transition from the five-year CPP period to the subsequent pricing period" is of great concern. Five years is more than enough time for a genuine change in strategy, from network to non-network solutions."

20. The widely held view by distributors and the Commission that forecast changes in the demand for line services affect only enhancement and development capex we think needs to be reviewed. In some scenarios, base capex (renewals) may be prone to lower cost non-line substitutes. Such risk of economic stranding may not occur in the immediate next 5-years of a CPP application, but it may and should be considered a risk in a whole-of-economic-life analysis for base capex as well as enhancement and development capex.

Tauranga area & Whangamata projects and reactive maintenance need to be reviewed

21. Contact Energy undertook a detailed analysis of various projects around Tauranga and the Whangamata project. Contact Energy submitted:[24]

> "In your draft determination your response to our submissions highlighting concern over a lack of consideration of third party alternatives is as follows:
>
> > *"In respect of Powerco's proposed major growth projects, it was clear to us that Powerco's Eastern region (i.e. Tauranga and the Coromandel) is experiencing significant population growth and that demand side responses alone would not be sufficient to meet this increased demand."*
>
> This view on future demand is problematic. Powerco has not tested the market for demand side responses. There is no factual basis of which we are aware, for the view adopted by the Commission.
>
> Regardless of that point, demand side responses do not need to meet 100% of projected future demand – there may be value in deferring capex for one or more years. Logically, therefore, not being able to meet 100% of future demand is not a reason to presumptively exclude from consideration demand side responses."

22. The above views by Contact Energy complement the analysis by NZIER for MEUG noting Powerco's application had a bias when estimating individual project net benefits by calculating benefits all at peak demand periods when actual benefits will accrue at various times.[25] The submissions by Contact Energy and NZIER raise important issues the Commission should address.

23. Contact Energy note their prior submissions on stand-alone diesel generation and diesel plus battery options for the Whangamata project were not addressed or at least insufficient justification given to include draft decisions to approve work in the bottom-up calculation of the CPP revenue cap.[26] Helpfully Contact provide more analysis to support its view that up to $6m of all-of-life costs might be saved for consumers if a diesel generator owned by a third party were used instead of Powerco's proposed battery/diesel option.[27]

[24] Contact Energy submission, paragraphs 2.13 to 2.15.
[25] 'NZIER Submission on Powerco CPP draft decision, 15 December 2017, Section 2.2 pages 5 to 7 describes the Powerco use of peak demand to value the benefit of avoiding lost load. This assumption overestimates the benefit of avoided lost load because nearly all the avoided lost load will not be at the peak demand level. Section 2.2.1 pages 7 to 9 shows the effect on estimated project net benefits of based on more realistic assumptions about the level of the avoided lost load.
[26] Ibid, paragraph 3.3.
[27] Ibid paragraphs 3.5 to 3.8.

24. In relation to reactive maintenance Fonterra noted:[28]

> "The draft decision paper does not propose any opex reduction initiatives.
>
> The 7% increase in reactive maintenance as appose[d] to a reduction over the CPP is a disappointment as it would be prudently expected that the significant increase in new equipment capex as well as a 33% increase in preventative and corrective maintenance would deliver at worst the same annual spend if not better performance. Failure mode analysis would assist in assuring that forecast expenditure will resolve the root cause of the failures and stop future repeat events. Fonterra recommends that the CC consider such analysis and for PowerCo to address the root cause of failures.
>
> In paragraph 445 it is noted that reactive maintenance will reduce resulting in a cost reduction across future pricing periods, but our view is that those savings should be reflected in this CPP determination. Fonterra recommends that the CC consider reflecting these savings during this period of the price path."

25. Fonterra's query on why customers are being asked to pay an increase in reactive maintenance when, given the material increase in capex and preventative and corrective maintenance, a reduction in reactive maintenance would have been expected is a reasonable common-sense question. MEUG recommend the Commission reconsider the draft given the material, that is 7% increase, proposed for reactive maintenance.

Concerns on quality of PODs and OAEETs and why sum of those net benefits is not equivalent to an estimate of the net benefit for the application as a whole

26. Given the preceding section on the submissions of Contact Energy and Fonterra on the Tauranga area projects, Whangamata projects and reactive maintenance, MEUG notes:

- While it has been useful to have the PODs and OAEETs published, albeit late in the process, there are concerns on the quality of those analysis of options; and
- The PODs and OAEETs are estimates of CBA for specific projects. As noted we and other submitters have doubts on the robustness of assumptions used to value lost load and define alternatives used in the analysis.

  Setting that aside we wonder if the draft decision that a CBA of the application as a whole is not needed relies on the view that CBA have been undertaken for major projects in the PODs and OAEETs and therefore a decision can rely on the sum of those project CBA to support decisions. MEUG believes there are problems with that approach if relied on by the Commission. In particular each project CBA would have to have a weighting put on the relative quality effect for that project relative to all projects because enterprise wide quality metrics are used in the final determination. This problem would be addressed by having disaggregated quality and price specifications such as using more granular regions and voltage classes.

[28] Fonterra submission, paragraphs 2.1 to 2.3.

The Network evolution proposal

27. MEUG did not submit on the draft decision that the $18m proposed expenditure for network evolution not be included in the bottom-up estimate of costs to calculate the aggregate CPP revenue cap because we agreed with that view in our prior submission on Issues to Explore and Consider.[29]

28. To be clear we agree the logic in the draft decision to decline the $18m network evolution proposal is sufficient; but not necessarily comprehensive. The reason for the latter caveat being the draft decision did not explicitly consider our September submissions that developing more cost-reflective prices would be a better use of resources to enable efficient adoption of emerging technologies by Powerco, suppliers to Powerco, customers and their agents.[30] We have been left not knowing if the Commission agree or disagree with that submission.

29. Powerco submissions on the draft decision to reject the network evolution proposal:[31]

- Did not consider the important role, in our view as mentioned in paragraph 28 above, of adopting cost-reflective prices to facilitate efficient innovation across the supply chain. We think pricing is an important part of the joined-up strategy considered in the draft decision and discussed in the next sub-paragraph.
- Failed to bridge the gap in the CPP application identified in the draft decision:[32]

> "However, we consider Powerco needs to provide more tangible justification underpinning how consumers are likely to benefit from the specific projects it is proposing to undertake. In particular, we consider that:
>
> - Powerco has not developed a joined-up network evolution strategy that identifies how and where all of the projects fit together or why they are needed now;
> - The benefits to consumers, and when these can be expected, are not sufficiently identified or articulated in Powerco's individual business cases for each of the network evolution projects it proposes; and
> - The CPP proposal appears to rely on the assumption that consumers are the only funding source for this programme. However, the programme is likely to offer benefits to stakeholders other than consumers and we would expect to see those stakeholders also contribute to the cost."

Powerco submissions provided no joined-up strategy that included identifying benefits to customers, generators, ancillary service providers and non-network solution providers and how those beneficiaries might contribute to Network evolution research and trial costs.[33] Therefore, MEUG sees no reasons in the Powerco submission to alter the draft decision.

[29] MEUG to CC, Powerco CPP proposal, 22 September 2017, Part 2.5 Network evolution capex, paragraphs 2.32 to 2.34.
[30] Ibid, paragraph 2.34.
[31] Powerco submission, paragraphs 20 to 27 and report by Allan Miller Consulting Ltd
[32] Draft decision, paragraph 298.
[33] For example, the report by Allan Miller Consulting was not a joined-up strategy. That report considered overseas experience in the sub-activities proposed by Powerco for Network evolution. Overseas experience can be useful though often can have limited relevance give most overseas countries either have a greater reliance on subsidies and very low rates of renewables in their supply portfolio that skew policy frameworks.

30. Aurora Energy submission on network evolution mainly covered the debate covered in the separate related party transactions topic and therefore isn't relevant to the CPP decision.[34] The last paragraph of Aurora's section on network evolution stated:

> "We would urge the Commission to reconsider its position on network evolution expenditure. Our view is that Powerco's proposal for modest network evolution expenditure provides a relatively low risk (for consumers and Powerco) opportunity to test and develop new network technologies and to evaluate how consumers' use of emerging technology will affect and influence the provision of network services into the future."

31. MEUG does not consider $18m or capex over 5-years to be modest. Neither is the proposed work clearly low risk to Powerco and its customers. If it were low risk why wouldn't Powerco undertake the work itself by substituting for other "approved" work that was used in determining the CPP revenue cap knowing it could bank a return with a 67th percentile uplift on expected risk? From a customer perspective, there is absolute certainty they will bear all costs if "approved." However, as the draft decision notes, it's unclear if customers collectively will benefit from this research and trial work or whether the distribution of benefits across customers will align with allocation of costs.

32. Finally, continuing a theme of our views on network evolution, Aurora fail to mention the importance, in our view, of cost-reflective prices to achieve what Aurora view as a key policy "… to test and develop new network technologies and to evaluate how consumers' use of emerging technology will affect and influence the provision of network services into the future."

Yours sincerely

Ralph Matthes
Executive Director

[34] Aurora Energy submission, pp2-3.