



30 January 2019

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Dear Dane

### **Cross Submission on EDB DPP3 Reset**

#### **Summary**

1. Orion welcomes the opportunity to cross submit on submissions to the Commission's issues paper on default price-quality paths for electricity distribution businesses from 1 April 2020.

#### **General comments**

2. ERANZ submitted that "Customers are also facing potential cost increases as a result of upcoming EDBs investments to refurbish and replace aging network assets and strengthen distribution networks to meet the expected future needs of customers." We agree that DPP3 may be unique given the simultaneous occurrence of lifecycle investment required to address asset conditions, a need to consider new requirements due to a change in customer choices around energy use particularly in terms of LV networks, connections and system control, and a number of EDBs also have growth requiring capital expenditure on new assets. The resultant capital expenditure from these activities is cited in submissions<sup>1</sup> as a reason not to raise the capex retention factor above 15%.
3. Genesis<sup>2</sup> takes a blanket approach to their assessment of EDB performance suggesting that assets are in poor condition which points to underinvestment while also pointing to inefficient over expenditure, poor quality performance and customers paying the price through high prices. They state that "Although lines prices have

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<sup>1</sup> For example Vector submission on DPP3 point 209

<sup>2</sup> Genesis submission on DPP3 pg1 & 2

continued to rise throughout DPP2, this has not resulted in either improved reliability nor better asset conditions of distribution networks.” We dispute this and also note that their commentary on increasing costs include transmission. This is somewhat misleading as these costs are a pass through cost and not in distributors’ asset management control. ENA<sup>3</sup>, in their submission to the Electricity Pricing Review were more specific. They submitted that in the period 2004 to 2017 “distributor charges have increased an average of 1.4 percent per year in real terms, the lowest change of the five components of an electricity bill.”

4. We note the Electricity Pricing Review stated that there was “nothing to suggest grid operator Transpower or distributors are making excessive profits.”<sup>4</sup>
5. We believe we are good stewards of our assets as are many EDBs. We have met our reliability limit during our CPP. The Commission one page summaries for industry in both 2017 and 2018 show on average all asset categories ‘in the green’. Naturally individual EDBs have different asset profiles so the context<sup>5</sup> behind the diagrammatic representations of asset health are important and reinforce the value of AMPs. Asset management is a dynamic process and the risk context (asset criticality) for particular assets is important when considering asset health and prioritisation of assets within work programmes. Our customers continue to tell us they are satisfied with the service we provide.
6. In our submission we asserted that it was timely for introduction of enhanced incentives for innovation, but that the paper did not propose any specific incentives<sup>6</sup>, and Powerco agrees<sup>7</sup>. The submission by Forensic Technologies International (FTI) and Compass Lexecon (CL) on behalf of Vector provides useful direction for regulatory innovation tools that may be considered such as innovation specific and uncertainty mechanisms. Specifically FTI-CL point out that “...innovation activities tend to be riskier in comparison with EDBs’ business-as-usual activities and as such are likely to require specific recognition within the framework to ensure an optimal customer outcome.”<sup>8</sup> We agree.

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<sup>3</sup> ENA submission to electricity pricing review page 7

<sup>4</sup> Electricity pricing review: first report page 5

<sup>5</sup> For instance in 2017 Orion’s one-pager indicated zone-substation transformers ‘in the red’ which was alleviated by 2018. This was a result of our purchase of a spur asset substation containing 3 single phase transformers which were in poor condition. Our asset management of these post purchase remediated this situation and reflected in the one-page indication for zone-substation transformers in the 2018 one-pager.

<sup>6</sup> Orion submission on DPP3 point 5

<sup>7</sup> Powerco submission on DPP3 page1 and 4

<sup>8</sup> FTI-CL Consulting submission on DPP3 page 41

### **Expenditure forecasts and AMP**

7. In our submission we highlighted that the Commission appeared not to favour the expenditure scrutiny framework applied in the gas reset. Powerco suggest in their submission that the use of a stepped approval process like that used in the gas reset may be useful for minimising costs<sup>9</sup> and we would support that.
8. Genesis Energy rightly submitted that “It is essential that each EDB capex forecast is clearly linked to their asset management plans.” We agree, as do others, and resubmit that the use of the quantitative **and** qualitative information provided in our 2018 and 2019 AMPs will reduce information asymmetry for the Commission and provide appropriate justification and evidence for setting opex and capex expenditure allowances for our reset. We provide some examples of the demands being placed on us by customers, community and government in point 4 of our earlier submission.
9. Wellington Electricity states<sup>10</sup> this well when it says “AMPs are developed through a robust internal planning process based on detailed knowledge of asset performance, local economic drivers and network characteristics, are subject to internal review and robust governance arrangements, and have received Director Certification of the reasonableness of expenditure forecasts. The AMP also incorporates the lifecycle of assets in its forecasting, whereas forecasting using historical expenditure does not.”

### **Operating Expenditure**

10. In our submission<sup>11</sup> our view was that there was not necessarily an inverse relationship between capital expenditure and operating expenditure attributable to asset replacement renewal. In their submission Wellington Electricity<sup>12</sup> also agree there is not an inverse relationship supported by some data analysis.
11. We would support further consideration of an uncertainty mechanism for the impact of changes to the trees regulations and operating costs relating to smart metering data as suggested by Vector.<sup>13</sup>

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<sup>9</sup> Powerco submission on DPP3 page 2

<sup>10</sup> Wellington submission on DPP3 page 3

<sup>11</sup> Orion Submission on DPP3 point 31

<sup>12</sup> Wellington Electricity submission on DPP3 Figure 3 page 8

<sup>13</sup> Vector submission on DPP3 page 45 and 46

### **Capital Expenditure**

12. Wellington Electricity caveats a cap on capex expenditure with the requirement for a mechanism that would allow one-off capital programmes within the DPP model for capital expenditure over the cap. This would alleviate the repeated concern by EDBs in submissions about large one-off unexpected capex projects, often driven by customer demand. We support Wellington Electricity's suggestion.
13. Wellington Electricity<sup>14</sup> rightly disagrees with the Commission deriving a capex model and effectively replicating EDB capital planning functions. We agree with Wellington Electricity.
14. Both Aurora<sup>15</sup> and Orion<sup>16</sup> do not support greater scrutiny of capital contributions. Both point out that customer connections and asset relocations are the key drivers of capital contributions and are difficult to forecast with precision. In particular Aurora states "Separate scrutiny, in our view, increases the likelihood of forecast error."

### **IRIS incentive**

15. Unison<sup>17</sup> suggest category level capex retention factors or banded approaches based on AMP forecasts. Specifically, a lower retention factor applying for expenditure up to the value of AMP forecasts, and a higher retention factor for above AMP forecasts. We would support further consideration of this approach tempered by Vector's<sup>18</sup> submission that the level of capex retention factor must balance the risk of deferral to meet incentive when important capital replacement and renewal programmes are forecast for DPP3.

### **Quality – SAIDI/SAIFI**

16. Submitters were generally in agreement with retaining the 2 out of 3 rule for quality.
17. In line with Orion's submission, many submitters supported the use of the latest 10 year period as the reference period for quality. However most did not support the removal of extreme years from the reference period. Submitters suggested that this would affect boundary values and Mercury noted "This would compromise the accuracy of performance."
18. Vector<sup>19</sup> does not support the removal of breach related events from the reference dataset. Orion agrees<sup>20</sup>.

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<sup>14</sup> Wellington Electricity submission on DPP3 page 10

<sup>15</sup> Aurora submission on DPP3 point 5.10 and 5.11

<sup>16</sup> Orion submission on DPP3 points 38 and 39

<sup>17</sup> Unison submission on DPP3 point 15

<sup>18</sup> Vector submission on DPP# page 209

<sup>19</sup> Vector submission on DPP3 point 136

<sup>20</sup> Orion submission on DPP3 point 49

### **Quality incentive**

19. The balance of submitters including MEUG/NZIER, ENA, Aurora, Alpine, Eastland, Powerco, Unison, Wellington Electricity and Orion submitted that an increase in the quality incentive from 1% to 5% is too great a change, may encourage over investment at odds with customer feedback and will not be in the long term interests of consumers.
20. In our submission<sup>21</sup> we pointed out that “DPP2 is the first regulatory period in which IRIS applies and the true impact of this incentive will only become apparent at the end of DPP2. The Commission overlooks the quality incentive as another potential recoverable cost that may be a source of price shock. This would be escalated in DPP4 if an increase from 1% maximum allowable revenue to 5% occurred in DPP3.” Some submitters support retention at 1% and others suggested an increase to 2 or 3%<sup>22</sup> may be more appropriate.
21. Orion supported the idea in the issues paper of a contravention report<sup>23</sup> when EDBs breach limits. We note however Aurora’s suggestion for application of a deadband<sup>24</sup> around the compliance limit and we would support further consideration of this.

### **Other measures of quality of service**

22. Most submitters supported the addition of customer service measures to the information disclosure regime. Submitters noted that how these are defined is important to ensure collection of the relevant data is practical, repeatable and has a cost in line with the benefit so that the information is worthwhile, accurate, consistent and its collection sustainable over time. Fonterra suggested a number of alternative measures<sup>25</sup> than proposed in the issues paper which we believe may have merit and we support further consideration of these.

### **Revenue cap and price shock**

23. We acknowledge that retailers have submitted strongly their concern that customers should not be subject to price shock. We agree. The regulatory regime needs to ensure that the incentives put in place do not create this potential, not only in the current reset but in terms of flow through to subsequent reset periods via recoverable costs.

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<sup>21</sup> Orion submission on DPP3 reset point 67

<sup>22</sup> Alpine and Aurora

<sup>23</sup> Orion submission on DPP3 reset point 54

<sup>24</sup> Aurora submission on DPP3 reset point 6.11

<sup>25</sup> Accuracy of notified outage start and completion times, communication of updates during an outage, number of planned outages to same customer e.g. minimise multiple planned outages to individual customers.

### **Power quality**

24. Aurora<sup>26</sup> suggests that a more important measure of power quality is how issues are addressed when they arise. We would support ID reporting on power quality complaints that details whether the power quality issue was a result of a deficiency on the HV, network owned LV or customer servicemain. This could be an appropriate lead indicator for cluster problems developing due to emerging technology, localised underinvestment or lack of servicemain maintenance.

### **Incentive on energy losses**

25. NZIER on behalf of MEUG submitted that the costs and benefits of an incentive to reduce line losses is important to inform if an incentive scheme would be beneficial. Specifically, we note that their analysis<sup>27</sup> suggests that the incentive on Orion of the proposed approach would be \$0.2m and for the alternative approach suggested by NZIER \$0m. This would not be a useful incentive for Orion and we would be better to continue the asset management approaches we already apply. As Wellington Electricity<sup>28</sup> submits “To meaningfully reduce [our loss] factor further this would require significant investment and it is possible the benefits will not outweigh the high cost.” We agree. We discussed the idea of a losses incentive in detail in our submission<sup>29</sup> and concluded that “the Commission would be better to focus on supporting EDB analysis, monitoring and expenditure [capex or opex] on low voltage systems which could include identification of phase imbalance.”

### **Indices/escalators/econometric approach**

26. While MEUG advocates for a 1.5% productivity factor (US example) based on 2014 Economic Insights work we question the relevancy of this to the New Zealand jurisdiction in 2019. Unison<sup>30</sup>, Aurora<sup>31</sup> and Wellington Electricity<sup>32</sup> submitted that a refresh is necessary of the evidence based approach taken by the Commission in 2014 via the Economic Insights analysis and report for DPP2.
27. In particular Wellington Electricity, Unison and Orion<sup>33</sup> point to a tightening of the industry specific labour market as a driver for refreshing the empirical evidence.

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<sup>26</sup> Aurora submission on DPP3 point 7.2b

<sup>27</sup> NZIER submission on DPP3 reset, table 6 incentives to reduce line loss for EDBs

<sup>28</sup> Wellington electricity submission on DPP3 point 10.1

<sup>29</sup> Orion submission on DPP3 reset points 79-87

<sup>30</sup> Unison submission on DPP3 point 11, 12 and 21

<sup>31</sup> Aurora submission on DPP3 point 4.6

<sup>32</sup> Wellington Electricity submission on DPP3 page 3 and 9

<sup>33</sup> Orion submission on DPP3 point 89

### Other matters

28. Fonterra submits their support for increased scrutiny of AMP's by accredited auditors to ISO 5000 "Asset Management". We disagree to this being a regulated requirement. This would increase compliance costs and disproportionately for smaller EDBs. An annual Asset Maturity report is already a requirement of producing an asset management plan. The report on Asset Management Maturity questionnaire has been prepared to conform to the PAS 55 specification.<sup>34</sup> While this is a self-assessment requirement some EDBs such as Orion already elect to carry this out using independent auditors.
29. We submitted against inclusion of LV and MAIFI reporting and/or incentives. Wellington Electricity<sup>35</sup>, Eastland<sup>36</sup> and Vector<sup>37</sup> agree and support our comments that the cost of implementing systems for this will outweigh the benefit to customers. We suggested that the Commission's attention on expenditure and programmes of work for LV systems would be more beneficial.
30. Vector<sup>38</sup> discusses the important aspect of resilience in EDB service delivery. Orion has been considering this aspect also. Of importance is the lack of a strong correlation between resilience focussed spend and a short term positive impact on service level performance. Not all expenditure impacts SAIDI/SAIFI performance e.g. EQ strengthening of buildings, provision of back-up data centres, replacement of oil-filled cables to improve event resilience and post-event response. The benefit of this capex expenditure is not realised until the significant event occurs and so may not register in improved SAIDI/SAIFI performance in the near term.

### Concluding remarks

Thank you for the opportunity to provide this submission. We do not consider that any part of this submission is confidential. If you have any questions please contact Dayle Parris (Regulatory Manager), DDI 03 363 9874, email [dayle.parris@oriongroup.co.nz](mailto:dayle.parris@oriongroup.co.nz).

Yours sincerely



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<sup>34</sup> Electricity distribution information disclosure determination 2012 (consolidated April 2018) Schedule 13 clause 1.3

<sup>35</sup> Wellington Electricity submission on DPP3 page 4 and point 7.3.6, 7.3.7

<sup>36</sup> Eastland submission on DPP3 point 4.6 and 4.7

<sup>37</sup> Vector submission on DPP3 points 183-187

<sup>38</sup> Vector submission on DPP3 point 11 and 12