

18 January 2021

Commerce Commission
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Dear Sirs

Thank you for providing the opportunity to comment on the Commission's draft decision on Aurora's Customised Price Path Application.

While Northpower is not subject to Price Quality Regulation, we take a keen interest in regulation in the sector. We view effective regulation as a key enabler of timely and efficient investment in the sector and we actively seek to keep pace with and learn from advancements arising from regulation in the sector. The Commission's focus on ensuring that regulated businesses deliver advancements in asset management maturity and their promotion of risk based investment decision making are recent examples

Within this context, Northpower would like to note material concerns with some aspects of the Commission's draft decision on Aurora's Customised Price Path Application (if they were to be ratified in the final decision). Most significantly we are concerned that the positive developments made by the Commission to advance the predictability, reliability, and effectiveness of the regulatory regime over recent years, may be undermined by creating a situation where Aurora are left underpowered to deliver on its commitments.

As professional asset managers ourselves, and as a company who services a significant proportion of NZ's distribution assets, our strong view is that network operators and regulators should take a cautious and prudent approach to future network investment. Given the implications for public and worker safety – we should work hard to avoid an environment where underinvestment is tolerated or is an unintended outcome of regulatory processes. Our understanding is that the current management team at Aurora is in fact seeking to address the implications of such prior underinvestment and that their CPP submission is geared to achieve that.

We believe the Commission has worked hard to ensure that the long term interests of consumers are balanced by incentives for distribution businesses to efficiently invest in their network assets and to deliver services that customers expect and value. The draft decision (if ratified) may undermine these positive developments and be a backward step for the regulatory regime as a whole. Our specific concerns are set out overleaf:

Area of regulation	Summary of positive regulatory developments	Concerns in relation to the draft determination
<p>Ensuring safe resilient infrastructure.</p>	<p>The Commission’s stance on supporting necessary network investment to ensure safety, reliability and resilience of distribution networks has had a positive impact over the past decade.</p> <p>In our view, it has provided a positive environment for EDBs to lift their asset management capability, lift the prudence and efficacy of their asset management programmes, and to push forward with key investment proposals.</p> <p>We see this as an appropriate stance for New Zealand given the critical enabling role of electricity distribution assets for the sector and for the communities we all serve.</p>	<p>Putting aside Aurora’s history, we consider Aurora’s CPP application a positive and necessary correction to historical asset management practice. From the perspective of industry credibility, we were pleased to see Aurora’s new management team take strong and necessary action, and we were pleased to see the Commission broadly support the capital proposals set out in its application.</p> <p>We however have concerns that the proposed downward adjustments to non-network operating expenditure will leave the organisation underpowered to deliver this critical correction. It would be a poor outcome for the community Aurora supports and a poor outcome for the distribution sector in further eroding confidence and credibility.</p> <p>From our recent experience, a lift in internal resource and capability (non-network opex) is absolutely critical to support a lift in the asset delivery programmes. EDB organisational structure (particularly EDB only organisations such as Aurora’s) are highly interlinked and interdependent. Operational delivery cannot be achieved without strong enabling non-network support.</p>
<p>Robust critique of CPP proposals.</p>	<p>The introduction of the verifier has brought deep engineering and asset management rigour to the CPP review process. This has been a positive development and delivered an appropriate methodology to ensure appropriate expertise, assurance and critique for CPP applications.</p> <p>In our view, this has provided CPP applicants confidence that the level of engineering and asset management rigour required to support an application will be met, and confidence that CPP review will be based on the application’s asset management, engineering, and community needs merits.</p>	<p>We note the strong professional reputation of the Engineering verifier, the high level of scrutiny applied, and that the verifier was able to verify a high proportion of the capital and operating expenditure being proposed by Aurora. From our perspective, this appears to have been a deep and considered review under a ‘tripartite’ contract with Aurora and the Commission. The duty of care to the Commission was also clear within the underlying agreements.</p> <p>We are concerned that the Commission may choose to disregard selective portions of their advice in favour of desktop analysis tailored to peer comparison rather than utilising the detailed review provided. Given the highly independent nature of the various elements of any CPP application, selective refinement to the verifier’s recommendation may call into question the ‘risk balance’ and ‘deliverability’ of the final CPP decision.</p>

		<p>We see deep risks for all parties (Aurora, its community, and the wider energy industry) if the Commission or its advisors sought to ‘tune’ a verified application without the necessary depth of insight to the underlying engineering detail, and programme delivery design specific to the individual EDB. We recognise that highlighting areas of concern is an important part of the draft determination process, but encourage the Commission to put appropriate weight on Aurora’s response in its final decision.</p>
<p>Peer comparison and league tables.</p>	<p>The introduction of asset dashboards as a summary of disclosed information, and peer costing benchmarking groups had a positive impact on EDB focus.</p> <p>In our case we use it as a ‘first pass’ check on our investment strategies and operational costs and outcomes are actively discussed with our Board. It has been useful in flagging areas where we may have drifted out of position and putting a focus on these.</p> <p>The industry as a whole has moved to utilise this information, but in doing so recognises that these comparison tables are necessarily limited, including inconsistencies in data interpretation, the timing of each EDB’s investment lifecycle, and the differing characteristics of each EDB.</p>	<p>We note that in this case the application of cost league tables has been utilised to cross check, and potentially overturn selected parts of the detailed work provided by Aurora in its application itself reviewed and verified by the Verifier. Non-network operating expenditure is the most notable area this has been adjusted.</p> <p>We are concerned that benchmarking data may be used to define the ‘correct’ value for non-network operating expenditure regardless of its limitation in this very ‘specific’ capacity. While the Commission’s advisors have supplemented this with their own Executive Challenge view, we are concerned any such external critique of organisational design is highly subjective.</p> <p>From our perspective a CPP application is to enable the necessary investment plans, execution plans, and operational plans to be developed to address company specific issues and deliver a step change in organisational outcomes, ultimately to benefit consumers. Shifting away from this bottom up basis and attempting to apply broad benchmarking creates the risk of arbitrary and adverse outcomes and unforeseen execution risks.</p> <p>As per our prior comments, we acknowledge the value of benchmarking to identify potential issues with an application, but encourage the Commission to consider in depth Aurora’s response given a much more specific bottom up approach has been applied.</p>
<p>Stable prices for end use customers.</p>	<p>We note that the DPP process has helped bring stability and predictability to distribution prices, with real prices remaining broadly</p>	<p>We note that in this case the Commission has applied a 10% cap on annual revenue increases, despite Aurora itself already moving to smooth pricing, despite</p>

	<p>flat across the industry for a material period. This is important for consumer confidence.</p> <p>We also note there have been material adjustments to EDB investment programmes accommodated at a local level and the needs case communicated locally. Historical price changes for Top Energy were one example.</p>	<p>investment being well ahead of DPP allowances in recent years, and despite current prices being well below industry averages.</p> <p>We have concerns at what appears to be a somewhat arbitrary cap, noting that where the Commission does conclude a revenue capping process is necessary, we assume a balance between customer outcomes, network outcomes, and organisational resilience would need to be struck.</p> <p>In this case, we see a risk that the decision will push up Aurora’s debt, impacting their resilience. As per our prior comments, we consider it important that Aurora is not put in a position which may lead to poor outcomes in the longer term.</p>
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We have provided these comments as an organisation who believes in the role of effective regulation, and as an organisation who believes recent developments in the regulatory regime for distribution have been positive. Our engagement in this consultation seeks to be constructive by recognising the strengths in the current regime, and highlighting areas which may undermine its overall effectiveness.

In summary - we are concerned that some aspects of the Commission’s draft decision for Aurora (if not corrected) may leave Aurora underpowered to deliver on its, largely independently verified, investment plan aimed at managing network risk and delivering critical community outcomes. This has the potential to not only impact Aurora’s customers but has wider implications too for industry credibility. Moreover, we are also concerned that such a punitive draft decision may deter others from applying for CPP decisions and lead to inappropriate investment deferral, and subsequently negative customer outcomes.

Northpower encourage the Commission to consider these points, and to do so in the context of wider energy policy in New Zealand. New Zealand is entering a period where effective distribution investment will be a key enabler of community growth and decarbonisation¹ and it is therefore essential that regulatory settings and approaches reflect and support appropriate investment.

¹ For example, as outlined in the Interim Climate Change Committee’s report *Accelerated Electrification* 30 April 2019.

We would be happy to discuss our thoughts further with you.

Sincerely



Andrew McLeod
Chief Executive



Josie Boyd
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