

# POWERCO

**Submission on**

## **The Commerce Commission ‘Issues to explore and consider’ consultation paper:**

**Invitation to have your say on Powerco’s proposal to change its prices and quality standards**

**Date: 22 September 2017**

## **1. Introduction and summary**

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1. Thank you for the opportunity to comment on the Commerce Commission's consultation paper 'Invitation to have your say on Powerco's Proposal to change its prices and quality standards' (the Issues Paper).
2. Our response is structured as follows:

**SECTION A:** General Observations and summary of response

**SECTION D:** Full responses to the Issues Paper questions

## **Section A**

### **2. General observations and summary of our response**

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3. This section summarises some general observations on the Commission's process and comments on some recent feedback we have received from our stakeholder engagement post our CPP application in June. These topics are not directly addressed in the Commission's issues paper, but are important, and so we have included our comments in this separate Section A, together with a table summarising our submission responses.
4. In the main section of our submission (Section B), we set our substantive responses to each of the specific questions posed by the Commission in its issues paper.

#### **2.1. Support for reliance on verification process**

5. As the Commission notes in the issues paper, prior to Powerco's CPP proposal being submitted in June, the work to develop the CPP proposal, the rationale and need for the investment proposed and the associated consultation process had already been subject to considerable advance scrutiny and review by an Independent Verifier; a mandatory requirement of the CPP process.
6. The verification process is intended to add value to the quality of an applicant's CPP proposal by rigorously testing the investment scenarios and options considered, the assumptions and cost / benefit analysis applied and the resulting customer benefits that will result, prior to an application being submitted. This is intended to enable the Commission's post application assessment to be more focused and targeted.
7. The Commission has thoroughly reviewed the verification report and the techniques and methods used to test Powerco's proposal and has confirmed that the review was thorough and undertaken to a high standard.
8. Powerco supports the Commission's proposal to rely on the verifier findings in completing their review. As the Commission notes, the verification team was able to verify most of the forecast expenditure proposed by Powerco in its CPP proposal (circa 91%). The Verifier's observation was that with further information and analysis, the Commission may satisfy itself that some or all of the amounts not fully verified prior to the application being submitted in June, may also meet satisfy the expenditure objective defined in the IMs. We support this being the focus of the Commission's current review and consultation.

#### **2.2. Network Evolution – positioning Powerco's future network**

9. Our CPP application includes a prudent programme of investment to test and develop new network technologies on our network and to evaluate how customers' use of emerging technology will impact on our ability to provide future network services. During recent discussions with a number of our retail customers and other stakeholders, we have been asked to provide greater clarity on the scope of this specific portfolio of proposed investment.
10. It is clear that technologies such as solar generation, battery storage, and electric vehicles are becoming mainstream, with further energy management applications emerging. As customers take up these new technologies, we also believe we will have to adapt how we operate our network. We want to ensure our customers are not limited in the technology options they have available due to our network. A key part of our network evolution strategy is to facilitate our customers' future energy choices and to make it easy for them to connect to and innovate over our networks.
11. The investment we have proposed under the broad heading "network evolution" comprises both technology trials and technology deployment with a network distribution

focus. It includes programmes that will support and deliver automatic fault detection and location, real time asset ratings, advanced asset condition monitoring, increased visibility of network performance, self-healing networks and integrating energy storage.

12. We are well placed to lead these technology trials as future deployment of these technologies is an integral enabler of us achieving our aim to be a next generation distribution network operator. We will seek to collaborate with others where appropriate but we have sufficient scale and maturity in asset management thinking to explore what the future energy landscape will look like and how we can provide network architecture that will help consumers achieve their objectives.
13. We will collaborate with other industry participants, and share knowledge where appropriate; although we note that collaboration is already happening across a number of areas.
14. We understand that transparency is important and we are also considering how we can provide a periodic update on our Network Evolution programme via an annual reporting mechanism which would focus on how we're progressing with our CPP works programme delivery.

### **2.3. Visibility of investment decision making and future investment drivers**

15. Feedback we received from our CPP consultation earlier in the year indicated that a number of stakeholders (mainly market participants) wanted EDBs to provide greater visibility on the options considered when progressing major network investments. We noted this in our main CPP submission. We have continued our engagement with stakeholders over the past few months, and a number of retailers have expanded on this theme of transparency, of investment decision making and process. They are particularly seeking greater visibility of how network and non-network solutions / options are identified by EDBs and assessed; particularly for larger projects. We also received feedback that asset management plans, published by EDBs, could be a vehicle for signalling in advance where potential future network and non-network opportunities might arise.
16. The above is a broader issue for the Commission and the industry to consider but it is relevant to Powerco's CPP proposal given the scale of investment on our networks over the CPP period. Powerco's annually published asset management plan is comprehensive and contains detailed information on future network drivers, load forecasts and forecast project opportunities.
17. As we signalled in our CPP submission we intend to take a lead in this area and work with our peers and stakeholders to assess how information and process transparency in this area can be enhanced.

### **2.4. Progress reporting during the CPP period**

18. The Commission's approval of Powerco's CPP application will enable us to undertake prudent investment in our electricity network so that we can continue to meet our customers' service expectations and support the communities we serve. In our proposal we have set out the work we currently forecast we need to do to deliver the outcomes we are targeting. We have also identified a number of areas where we are seeking investment approval to further improve our asset management practices (i.e. data, analytic, modelling etc.) and deliver overall business improvements.
19. It is important that we continue the transparency we have sought to embed in our CPP process to date, through open engagement and consultation, as we progress through the delivery phase of our CPP investment. We propose to work with the Commission over the coming months to develop a mechanism for us to report progress against the key commitments made in our CPP proposal. We recognise that the Commission (and our customers) will require Powerco communicate its progress in delivering the outcomes we have sought funding for.

20. As an option we are considering the merits of Powerco publishing an annual “CPP progress report” that would clearly demonstrate the company’s progress in delivering against a number of pre-defined targets and outcomes (both quantitative and qualitative metrics).

**Table summarizing Powerco’s response to the Issues Paper**

Topic	Comment
Chapter 1: Quality – issues relating to Powerco’s proposed quality measures and standards	We believe that normalised SAIDI/SAIFI is more appropriate to model SAIDI and SAIFI trends than un-normalised historical data as proposed by the verifier as it better reflects meaningful trends in underlying reliability. The CPP investments proposed have been modelled to generally maintain unplanned SAIDI and SAIFI at historical levels, which our customers have indicated is their preference (noting that arguably there is some longer term improvement but considerably beyond the CPP period). We maintain that excluding planned SAIDI/SAIFI from the quality path is in the best interest of consumers as it removes potential delivery constraints and potential perverse incentives.
Chapter 2: Long term pricing impact of Powerco’s CPP proposal	We are cognisant of the impact that our investment decisions have on consumer prices. During the development of our CPP proposal we have actively sought to mitigate price shocks and the overall impact on prices where possible. For a number of reasons we disagree with the Commission’s implication that Powerco should speculate where distribution prices could trend beyond the CPP period as this cannot be accurately derived due to uncertainty on how prices would be determined, the form of regulation that we will subject to at the end of the CPP and considerable uncertainty around key inputs. Our focus has been on demonstrating that our proposed investment during the five year CPP period in question meets the expenditure objective, is prudent, timely, efficient and in the long term interests of consumers. We have no preference and remain open to the options on whether to adjust prices through a starting price adjustment or using year-on-year increases in order to lessen any initial price increase.
Chapter 3: Potential price volatility from WACC change during the CPP period	We have proposed applying a forecast WACC for the years FY21 to 23 when calculating our revenue requirement. This proposed approach, which we have set out in detail to the Commission, reduces the likelihood of fluctuations in consumer prices. Applying the IMs with our proposed modification is more consistent with the aims of price-quality regulation, as smoothed prices are more consistent with outcomes in competitive markets.
Chapter 4: Asset health and criticality and its impact on capex forecasts	We agree with the Commission’s view that being able to identify the most critical assets for replacement is important and continue to believe that our renewal expenditure to be prudent, particularly given the top down expenditure efficiencies included in our forecasts. We expect that our criticality framework (once fully embedded) will assist us with prioritising renewal investments. We intend to provide transparency on how we are progressing with these improvements through annual progress reporting.
Chapter 5: Network evolution capex	We have adopted a corporate objective to evolve to a distribution system integrator to prepare our network for the changes occurring in the electricity market. To achieve this, we have proposed a programme of investments in new network technologies. These investments all have a distribution network focus, and include programmes that will deliver automatic fault detection and location, real time asset ratings, advanced asset condition monitoring, increased visibility of network performance, self-healing networks and integrating energy storage. Not preparing for the changes occurring in the electricity market is likely to lead to higher costs to consumers in the long term.
Chapter 6: Opex forecasts	Our increase in SONS expenditure will deliver efficiencies for the longer-term benefit of consumers. Benchmarking of our expenditure against other EDBs indicates our proposed expenditure is efficient.
Chapter 7:	Significant work went into assessing our ability to deliver our investment plan as

Deliverability risk of Powerco's CPP proposal	it was developed. Since submitting our Proposal, we have continued to progress our CPP initiatives and remain confident in our ability to deliver the programme. We are committed to ensuring that the Commission and interested parties have access to information that provides increased transparency on the delivery of our CPP programme.
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## **Section B:**

### **3. Full responses to the Issues Paper questions**

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#### **3.1. Quality – issues relating to Powerco’s proposed quality measures and standards**

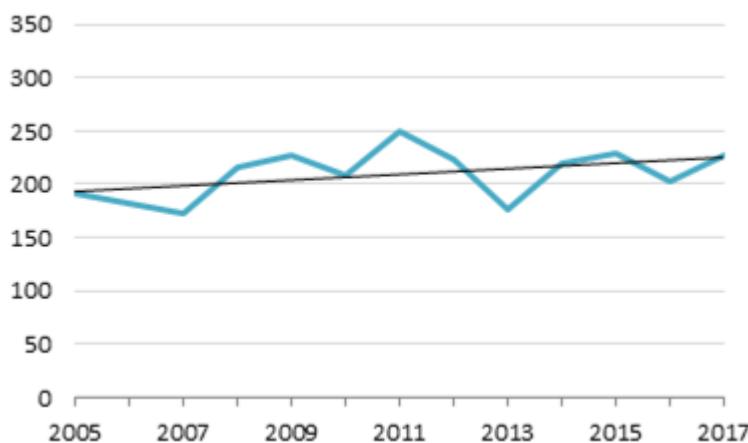
- The Commission has sought views on whether SAIDI and SAIFI quality targets set for the CPP period should be more reflective of expected improvements.
- We disagree with the verifier that SAIDI and SAIFI trends should be based off un-normalised historical data.
- We consider that normalised SAIDI/SAIFI is more appropriate as it better reflects meaningful trends in underlying reliability. We note normalised total SAIDI has trended upwards while normalised unplanned SAIDI has remained flat.
- Based on our modelling, our CPP investments are expected to generally maintain unplanned SAIDI and SAIFI at historical levels, which our customers have indicated is their preference.
- We believe excluding planned SAIDI/SAIFI from the quality path is in the best interest of consumers as it removes potential delivery constraints on the CPP programme and avoid potential perverse incentives to gain by reducing construction work.
- Other measures outside of SAIDI and SAIFI are difficult to incorporate into a quality path, as any new measures risk introducing unintended incentives, require robust data (not currently available to an audited standard) to set an appropriate standard, or carry little precedent.
- We intend however to increase our reporting and transparency on several measures.

#### ***Trend assessments should be based on normalised historical data***

21. The Commission has sought views on whether SAIDI and SAIFI quality targets set for the CPP period should be more reflective of expected improvements. The Commission has based this question on the observation made by the verifier that our historical expenditure on asset replacement and reliability had led to a distinct trend of improving reliability.<sup>1</sup>
22. We disagree with the Verifier’s findings that our historical SAIDI has improved over time. Their finding is largely based on deriving a trend from un-normalised, historical performance, starting in a high base-year. In our view, any trend assessment should be only based on normalised SAIDI (and SAIFI) data, not un-normalised/unadjusted information.
23. Normalisation is needed to reveal meaningful trends in underlying network reliability over time. Trends in unadjusted SAIDI provide a very ‘noisy’ measure of average reliability, and do not accurately reflect the underlying performance of the network, as it is highly subject to the influence of large external events outside our control (e.g., extreme weather).
24. Normalised total SAIDI on our network since 2005 is shown in the chart below.

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<sup>1</sup> Issues Paper, paragraph 77.



25. Unplanned normalised SAIDI on our network since 2005 is shown in the chart below.



26. The above charts show that our normalised total SAIDI has been trending upwards and unplanned SAIDI has been flat.

#### ***CPP investments are expected to maintain unplanned SAIDI***

27. We have modelled our expected unplanned SAIDI and SAIFI outcomes over the CPP period and beyond. Our CPP investments are expected to generally maintain unplanned SAIDI and SAIFI at historical levels, which our customers have indicated is their preference. The model indicates that if we were to invest at DPP a level (which is less than our most recent historical investment levels); SAIDI and SAIFI would deteriorate due to increasing asset failures.
28. It should be noted that our investments aren't only driven by the need to manage reliability— for example, many investments are for safety reasons (e.g. where there is a risk of catastrophic failure) and some of these may also improve reliability.

#### ***Planned outage incentives***

29. The Commission has sought views on potential options for ensuring there are incentives to minimise planned outages.
30. We considered a range of options for including planned SAIDI/SAIFI in our quality measures, and concluded that excluding it from the quality path was the most pragmatic approach:

- 30.1 Other options, including using a forecast of planned SAIDI/SAIFI, could introduce perverse incentivises to not deliver our CPP programme to avoid a quality standards breach.
  - 30.2 Similarly, an ability to benefit from a revenue gain associated with lower than target planned SAIDI/SAIFI may introduce a further perverse incentive to limit construction work, impacting on the CPP works delivery.
  - 30.3 We have strong financial drivers to minimise planned outages as service delivery costs will tend to increase if outages are longer or more disruptive than planned.
31. While we consider excluding planned SAIDI/SAIFI from annual reliability measures is the most appropriate solution, we are open to exploring alternatives that achieve the same objective, including and incentive based and multi-period reporting options if these do not add unnecessary cost or complexity and impact on our incentive to deliver the work required.
32. Given the importance that we know customers place reducing the number and duration of supply outages we propose to work with Commission to agree a suite of “customer service” reporting metrics (outside of the formal quality path) with the aim of providing transparency of our annual performance in this important areas.

#### ***Other quality measures***

- 33. The Commission has sought views on what other service measures are important to consumers and how these should be taken into account.
- 34. Other measures, beyond SAIDI and SAIFI, are difficult to effectively incorporate into a quality path, as any new measures either risks introducing unintended incentives, require robust, audited data to set an appropriate standard, or have no useful precedent (particularly non-technical measures).
- 35. It is also expected that Powerco will revert to a DPP at the end of the CPP period and it will important that any CPP quality path can be easily transitioned.

### **3.2. Long term pricing impact of Powerco's CPP proposal**

We are cognisant of the impact that our investment decisions have on consumer prices. During the development of our CPP proposal we have actively sought to mitigate price shocks and the overall impact on prices where possible.

For a number of reasons we disagree with the Commission's implication that Powerco should speculate where distribution prices could trend beyond the CPP period as this cannot be accurately derived due to uncertainty on how prices would be determined, the form of regulation that we will subject to at the end of the CPP and considerable uncertainty around key inputs. Our focus has been on demonstrating that our proposed investment during the five year CPP period in question meets the expenditure objective, is prudent, timely, efficient and in the long term interests of consumers.

We have no preference and remain open to the options on whether to adjust prices through a starting price adjustment or using year-on-year increases in order to lessen any initial price increase.

#### ***Price impact considerations***

36. Our investment decisions have an impact on consumer prices. During the development of the CPP we have actively sought to include investments that will meet consumer needs and have as low an impact on consumer prices as possible.
37. We are confident our proposal reflects an appropriate balance between the investment needs of the network and our desire to minimise the impact on customer prices. During the development of our CPP Proposal we have:
  - consulted with stakeholders on price quality trade-offs;
  - looked to minimise the costs of delivering our investment needs, including moderation of our expenditure;
  - consulted with stakeholders on their preference for how our investments are reflected in prices, either through a starting price adjustment or year-on-year increases; and
  - proposed an amendment to the IMs to allow a forecast WACC to reduce the impact of forecast price fluctuations.
38. We remain open to further stakeholder input on how the impact of our forecast expenditure should be reflected in prices during the CPP period.

#### ***Prices in periods following the CPP period will be uncertain***

39. The impact of our proposed expenditure, on prices following the CPP period cannot be determined at this time because of:  
Uncertainty on how the Commission will set prices after the CPP period; and
  - Key inputs for pricing decisions following the CPP period not being known.
40. The IMs do not specify how the Commission would transition prices from a CPP. As set out in section 53X of the Commerce Act, the Commission has the option of applying prices that applied at the end of the CPP or setting a different starting price. The Commission is required to make this decision 4 months before the end of CPP period (FY23).
41. As a default Powerco would revert to a DPP at the end of the CPP period. Section 53X of the Commerce Act, provides an option of applying for another CPP at the end of the CPP period.
42. There is also uncertainty around key inputs. The most significant being the WACC assumption. We note that similar fluctuations to those experienced in the last five years

would have a greater impact on prices in the subsequent period than the proposed expenditure / commissioned assets profile.

***Initial price increase or year-on-year increases***

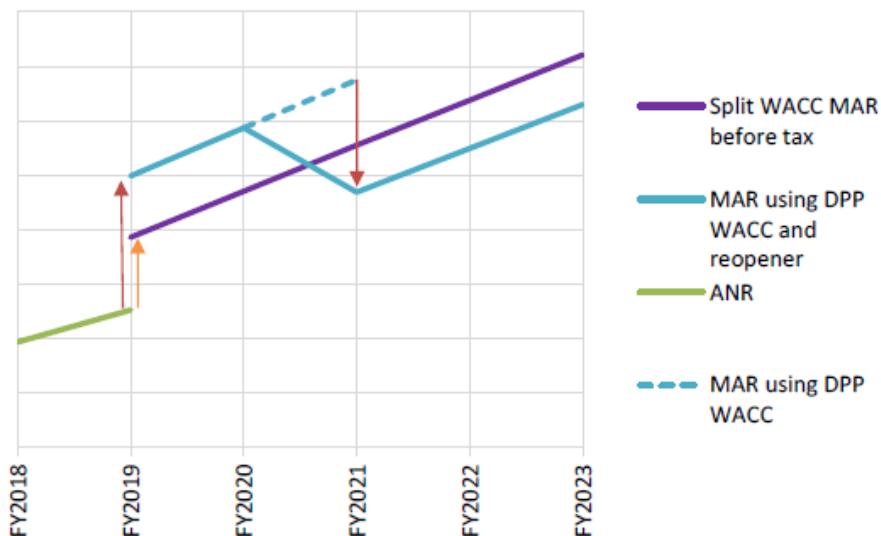
43. The Commission has asked for views on possible options for addressing the potential long term pricing impact, either in the CPP or subsequent pricing period. The Commission has outlined how this can be done through a lower initial MAR followed by steeper year-on-year increases.
44. Our consultation with customers did not identify a clear preference for either of the proposed options. Retailers, however, did indicate a preference for an initial price increase rather than year-on-year increases as a starting price increase is easier to administer.
45. The decision on an initial price increase or year-on-year increases should reflect customer preferences. We have no strong preference for either approach as it is NPV natural to us. We remain open to both options and welcome any further feedback from stakeholders.
46. The Commission has also asked for views on possible solutions to the expected increase in prices in the subsequent period and whether this impact should be considered in the subsequent pricing period decision.
47. As discussed above, a decision on subsequent period prices is not required until FY23 (4 months before the end of the CPP period). Given the uncertainty around the price impact for the subsequent period (see above) we support the Commission's considering this issue nearer to that decision. To clarify, we don't believe it's appropriate or necessary to make any commitment to that decision until more is known about that actual price impact.

### 3.3. Potential price volatility from WACC change during the CPP period

- We have proposed applying a forecast WACC for the years FY21 to 23 when calculating our revenue requirement. The proposed approach reduces the likelihood of fluctuations in consumer prices.
- Applying the IMs with the proposed modification is consistent with the aims of price-quality regulation, as smoothed prices are more consistent with outcomes in competitive markets.

#### ***Application of WACC forecast for the benefit of consumers***

48. As outlined in our CPP Application (Application, section 8.1), we have proposed applying a forecast WACC to reduce expected fluctuations in consumer prices during the CPP period.
49. The Commission has requested views on our proposed approach and asked how important the issue is to stakeholders.
50. If the IMs are applied without the modification, customers are expected to face increased price volatility during the CPP period, including:
  - a larger than proposed starting price increase (FY19); and
  - reduction in prices during the regulatory period (FY21).
51. The following chart illustrates the effect of the two approaches. Using only the prevailing 7.19% WACC in a CPP application causes prices to increase significantly when moving to the CPP in FY19 (represented by the first red arrow) then decrease significantly in FY21 through the reopeners (the second red arrow).
52. In contrast, a CPP application using a forecast WACC for FY21 to FY23 results in a lower increase in FY19 starting prices (represented by the orange arrow) and a smaller impact on FY21 starting prices arising from the reopeners. The impact of the reopeners is shown in this example as nil as the impact of the opener will not be known until the reopeners WACC is determined.



#### ***Proposed modification consistent with the purpose of Part 4***

53. Applying the modification as proposed, results in smoothed pricing, which is more consistent with outcomes in competitive markets.

### **3.4. Asset health and criticality and its impact on capex forecasts**

- We agree with the Commission's view that being able to correctly identify the most critical assets for replacement is important.
- We consider our renewal expenditure to be prudent, particularly given the top down expenditure efficiencies also provided for in our forecasts.
- We expect that our criticality framework (once fully embedded) will assist us with enhanced prioritising of renewal investments and we will make transparent how we are progressing in this area as part of our annual disclosure reporting.

54. We agree with the Commission's view that being able to correctly identify the most critical assets for replacement is important. This is a core feature of effective asset management and investment decision making.
55. We place a high priority on improving our asset management practices, as reflected in our assessment and reaction to the Commission's Asset Management Maturity assessment. We have been making improvements in this area, as reflected in our AMMAT score improving from 1.9 in 2013 to 2.4 in 2017. We plan to continue our improvement journey, and have set the goal of achieving ISO 55000 certification by 2020. A key enabler of improving our asset management is our additional SONS expenditure in areas of strategy and analytics capability.
56. We have used asset health modelling as part of our asset renewals forecast, and will continue to refine and evolve these models. This in part will rely on improved asset information, for which we have several planned initiatives, including a new ERP.
57. As noted in our Proposal, we have developed a criticality framework that we are currently embedding within our systems and processes. The framework takes into account the potential impact on consumers, public safety, environment and financial outcomes. We agree with the Commission that an asset criticality framework should cover more than just safety related aspects.
  - 57.1 So far we have focused on embedding the system for shorter term defect prioritisation, and expect to soon use the framework within our planning processes for longer term planned investments.
58. Our renewal models (informed by asset health and asset failure trends) forecast an overall renewal 'need'. We expect that an embedded criticality framework will assist us with prioritising renewal investments within our planning processes, but will not change the overall quantum of asset replacement required in the medium term.<sup>2</sup>

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<sup>2</sup> Effective risk assessment and associated prioritisation may defer maintenance or renewal work on an asset, but cannot avoid it in the medium to longer term.

### **3.5. Network evolution capex**

- We have adopted a corporate objective to evolve to a distribution system integrator to prepare our network for the customer-led changes we expect will occur in the electricity market, as well to maximise the potential benefit from technology developments.
- To achieve this, we have proposed a programme of investments to trial new network technologies. These investments have a distribution network focus, and include programmes that will deliver automatic fault detection and location, real time asset ratings, advanced asset condition monitoring, increased visibility of network performance, self-healing networks and integrating energy storage to defer other network investments.
- Being ready to effectively manage the implications of the changes occurring in the customer requirements, particularly keeping our network stable in the face of two-way power flows, rapidly varying local generation levels and potential significant short-term peak load increases, will avoid significant costs when these arise. This will be from our ability to substitute innovative, enhanced network (and non-network) solutions for large-scale conventional network reinforcements.
- Emerging technology also poses many opportunities to enhance the manner in which we build and operate our networks. Higher asset utilisation and longer asset lives lead to reduced investment requirements, and enhanced monitoring could enhance network reliability without increased costs.

59. Our Network Evolution programme is driven by two main factors:
  - enabling customer choice while keeping the network stable; and
  - realising opportunities offered by new technology for network operation, planning and management.
60. The environment in which we operate is changing rapidly. Technologies such as solar generation, battery storage, and electric vehicles are becoming mainstream, with further energy management and generation applications emerging. The use of these technologies impact on the stability of power networks and the quality of supply, and as they are taken up in larger volumes, we will have to adapt how we build and operate our network. We want to ensure that, from a network perspective, our customers are not limited in the technology options they have available. Therefore, a key part of our network evolution strategy is to facilitate our customers' future energy choices and to make it easy for them to connect to and innovate over our network, while we will continue to run it as a reliable, stable, and safe platform for their activities
61. Reflecting this, we have adopted a corporate objective to evolve to a distribution system integrator in the medium term (5 to 10 years).
62. In addition, new electricity network technology, offering huge improvement opportunities, is emerging at an escalating rate. This is the result not only of equipment improvements, but also of the increased efficiency with which network devices can be remotely monitored and controlled, and incorporated into automated systems. New technology is also supporting increased application of non-network solutions, such as demand side management (load reduction or load shifting) or dynamic electricity tariffs. Potential benefits from this technology include increased asset utilisation and asset lives, deferred network augmentation, self-healing networks, and improved network planning. In light of the considerable investment required to renew assets and augment our network, it is paramount that we seize opportunities to minimise costs without compromising service levels.

63. These drivers require us to investigate new technology solutions, with a focus on improving how we operate and manage our network. This work will initially support programmes that deliver automatic fault detection and location, real time asset ratings, advanced asset condition monitoring, increased visibility of network performance, self-healing networks, voltage stabilisation and integrating energy storage. Over time, these solutions will become part of our normal suite of tools and technology for managing our network. We will also continue to monitor new emerging technology, and test this where it offers potential network benefits.
64. Inadequate preparation for the changes in customer energy use patterns, or our ability to realise the benefit from emerging technology, will lead to higher energy costs to consumers in the medium to longer term, as we continue to apply (less effective) conventional solutions to address emerging issues.
65. We recognise that estimating the exact benefits from the planned programmes within the Network Evolution portfolio are less certain than for traditional network investments. However, international literature quotes multiple examples of substantial benefits arising from these programmes (such as a recent review by Ofgem of the benefits arising from the Low Carbon Network Fund supported pilot projects in the UK).
66. In order to ensure we realise the maximum benefits from our Network Evolution programme, we will adapt our expenditure governance processes. This will include additional processes beyond our standard expenditure governance such as increased benefits monitoring, additional stage gates during project implementation, clear criteria whereby decisions will be made to filter out projects that do not demonstrate material benefits, and an increased focus on capturing learnings from completed projects, and using that to inform future initiatives.
67. We can also learn much from others who have already tested these solutions, including other distribution businesses, academia, research institutes and suppliers and therefore plan to collaborate extensively with other industry participants, and share our experiences with our peers. This has always been the Powerco approach, as evidenced by our recent collaboration with Genesis on their Local Energy Project in the Wairarapa, exploring how customers will both consume and generate energy in the future. We are also heavily involved in industry forums such as the Smart Grid Forum, Electricity Networks Association, Drive Electric, Electricity Engineers Association and the Energy Management Association of New Zealand.
68. We are also well placed to lead these technology trials, with sufficient scale and maturity in asset management thinking to explore what the future energy landscape will look like and how we can provide a network architecture that will help consumers achieve their objectives. We have strong relationships with other EDBs, and those of smaller scale often look to us to help define or collate the thinking for the industry. Many EDBs already procure our asset and operations standards, a role which we take seriously and work with other EDBs to help them understand our thinking behind our standards.
69. We also intend to provide the industry regular updates on our Network Evolution programme via our annual CPP progress reporting.

### **3.6. Chapter 6: Opex forecasts**

- Our increase in SONS (particularly people capacity and skills) expenditure will deliver efficiencies for the longer-term benefit of consumers.
- Our proposed contact centre expenditure is to address an identified customer need.
- Benchmarking of our expenditure against other EDBs indicates our proposed expenditure is efficient.

#### ***Increased SONS expenditure will deliver long-term efficiencies***

70. During CPP period we have applied to our forecasts \$9m in Capex efficiencies (\$3m in FY22 and \$6m in FY23) and \$3m in Opex efficiencies (\$1m in FY22 and \$2m in FY20).
71. The Commission seeks views as to whether such savings are appropriate over the CPP period.
72. These efficiencies are expected as a result of asset management improvements delivered through our system operations and network (SONS) portfolio. We refer to this initiative in our CPP application as 'strategy-step changes'.<sup>3</sup>
73. The benefits of these efficiency improvements will be shared with our consumers through:
  - Future price resets, where prices will be based on lower actual costs than otherwise would be the case (i.e., in the absence of the step change)
  - Better reliability, resilience, public safety and customer service than they would otherwise experience (without the normally associated cost increases)
74. We expect these asset management improvements to change our cost structure in the long term, as the efficiencies are expected to not only persist but increase after 2023.

#### ***Corporate services FTE increase is prudent***

75. Our CPP Proposal notes we are forecast to increase our corporate services FTEs by 21 during the CPP period. This increase in FTEs relate to:
  - Increases in FTEs to administer the higher network activity and increased company-wide staff numbers; and
  - Additional FTEs in our ICT department to assist in delivering the ERP implementation:
76. The FTE forecast was based on a bottom up assessment of our requirements.
77. A top down assessment of the FTE increase indicates that the increase is prudent. The additional 21 staff (including the ICT increase that relates to the ERP implementation) represents a 15% increase in FTEs. This is prudent against an estimated increase in activity of 42% as represented by the increase in real expenditure between the last 5 years and the CPP period.

#### ***Including forecast efficiencies against the purpose of incentive based regulation***

78. We had extensive discussions with the verifier on whether it is appropriate to adjust, in advance, our expenditure forecasts for potential efficiency savings expected over the regulatory period.
79. Removing expected efficiencies before they are achieved reduces the value of the incentive mechanisms built into the DPP and CPP regulatory frameworks.

<sup>3</sup> The increase by 46 FTEs referred to in para 158 are required to deliver the additional investment volumes on our network.

80. However, the verifier recommended that we build in efficiency adjustments into our forecasts as this would be expected, given the additional funding requested under the CPP to achieve it. Our CPP proposal therefore already takes into account efficiencies resulting from investment to improve capability, capacity and deliver business process improvements.

### ***Contact centre – meeting customer needs***

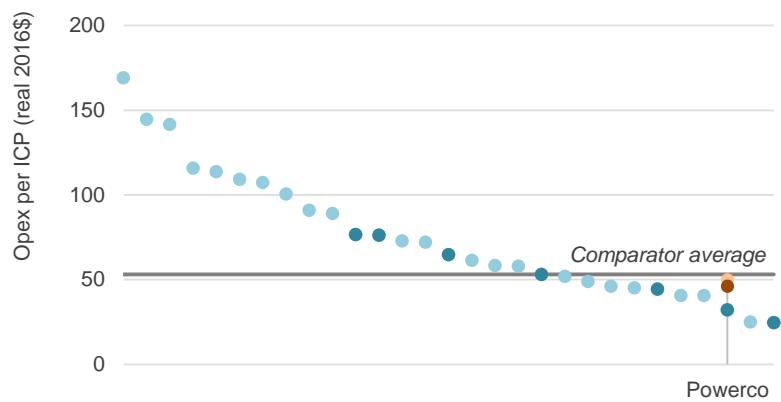
81. Our CPP application included provision for the implementation of a contact centre to assist us in meeting the need for effective fault communication. The Commission has sought views on whether the proposal to bring our fault calls in-house (by establishing a call centre) and the costs associated with this initiative provide good value for consumers.
82. Consultation with our customers has identified that our customers place a high value on good communication around supply issues<sup>4</sup>, and that under the current arrangements where retailers are responsible for fault calls they do not always get the service they expect.
83. The in-house call centre is expected to
- enable more timely, accurate and up to date information on outages and planned restoration times to be shared directly with affected customers; and
  - improve our ability to identify and rectify network faults.
84. Our proposal allows for an initial capital investment of \$0.1m and annual Opex of \$0.6m for the contact centre. This represents less than 1% of total Opex for the CPP period. We believe this is a prudent investment in meeting a highly valued customer need that is not currently being adequately addressed through current systems.
85. The contact centre is forecast to be operational from FY20. It is our intention to work with retailers in the lead up to its implementation to better understand how our customers' needs can be met on an overall efficient basis. This will include consulting with other EDBs to understand how they have achieved value for their customers by bringing fault communication services in-house.

### ***Benchmarking indicates our forecast SONS Opex is efficient***

86. To assess whether our current and proposed expenditure is efficient, we undertook cost benchmarking against New Zealand EDBs and FTE benchmarking against Australian (?) electricity distributors. We show the results of our benchmarking in the main proposal (Figure 15.12).
87. For reference, below we include our comparison of SONS expenditure per ICP (New Zealand comparison) from the main proposal. Our closest comparators are shown as dark dots, and our CPP/Post CPP relative position is indicated by the orange dots.

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<sup>4</sup> PwC have quantified that business customers are willing to pay \$467 per year and residential customers \$140 per year, for communication about power outages (Consultation report, page 20).



88. In our view, SONS expenditure has been too low in the past as evidenced by the emerging network needs, and supported by this benchmarking. Our costs, normalised on a per ICP basis, are at the lower end of EDBs in New Zealand. Making the simplifying assumption that our comparators average costs remain static over time, we expect to move from a position from well below average to a somewhat better than average position relative to our comparators (and still well below industry averages).

### **3.7. Chapter 7: Deliverability risk of Powerco's CPP proposal**

- Significant work went into assessing our ability to deliver our investment plan as it was developed.
- Since submitting our Proposal, we have continued to progress our CPP initiatives and remain confident in our ability to deliver the programme. This has resulted in us signing up agreements with two further major contracting businesses to help deliver the CPP programme.
- We are committed to ensuring that the Commission and interested parties have access to information that provides increased transparency on the delivery of our CPP programme.

#### ***Deliverability assessed as part of our Proposal***

89. The Commission has sought views on the on whether action is required to mitigate deliverability risk
90. Significant work went into assessing our ability to deliver our investment plan as it was developed.
91. As outlined in Chapter 8 of our main proposal document, during the development of our investment plans, we
  - modelled our required resources to assess where any resource capacity gaps were;
  - tested these requirements with our service providers and suppliers;
  - secured ‘in-principle’ agreements with service providers to deliver the forecasted increase in work; (these have subsequently been firmed up into binding agreements)
  - analysed and profiled our internal resource requirements to ensure that our expenditure plans were deliverable; and
  - took steps to ensure other resource requirements, such as consulting support, plant and materials, would be met.
92. The service provider agreements ensure suitable resources will available for increases in work, particularly for overhead line and defect remediation works.

#### ***We remain confident in our ability to deliver the proposed programme***

93. Since submitting our proposal, we have:
  - completed a realignment of our Asset Management and Operations teams; and
  - increased our asset management capability in areas of asset information, network evolution and investment optimisation.
94. The realignment of our Asset Management and Operations teams means they will be better placed for future work volumes and will enable them to more easily scale when additional resource is required.
95. The agreement with our service providers and work in preparing our internal resources for the increase in work load gives us continued confidence that we can deliver on our proposed programme of work.

#### ***Reporting on performance***

96. We support providing updates on the delivery of our CPP programme, to give assurance to stakeholders we are meeting our targets.

## **97. Process from here**

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98. Powerco appreciates the opportunity to provide input to the Commission's consultation paper.
99. If you wish to discuss this submission please contact Richard Fletcher, at [richard.fletcher@powerco.co.nz](mailto:richard.fletcher@powerco.co.nz), or on (04)978 9910, in the first instance.

Yours sincerely

A handwritten signature in black ink, appearing to read "Richard Fletcher".

Richard Fletcher  
General Manager Commercial and Regulatory