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Jo Lipscombe
Acting electricity Distribution Manager
Commerce Commission
44 The Terrace
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By email only: infrastructure.regulation@comcom.govt.nz

Dear Jo

SUBMISSION

POWERCO LIMITED'S TRANSITION TO THE 2020-2025 DEFAULT PRICE-QUALITY PATH

Aurora Energy Limited (**Aurora**) welcomes the opportunity to submit on the Commerce Commission's (the **Commission**) draft reasons paper on Powerco's transition to the 2020-2025 default price-quality path (**DPP**).

No part of our submission is confidential.

There are challenges in transitioning from the more complex settings of customised price-quality paths (**CPPs**), which are tailored to the specific requirements of the subject electricity distribution business (**EDB**), to the more general, industry-wide settings under the DPP framework. We consider that the Commission has appropriately managed this challenge and has arrived at a draft decision that is consistent with the Part 4 purpose[1], including the purpose of default/customised price quality regulation[2].

The draft decision aligns with the process used to reset the 2020-2025 DPP (**DPP3**), to the extent possible. Where direct application of the DPP3 process would likely result in an inconsistent or unreasonable outcome, the Commission has used appropriate and largely evidence-based discretion, in Aurora's view. However, we consider that there are improvements to the setting of non-network capital expenditure allowances that could yet be made before the final decision. We comment on this below.

A transition arrangement that strongly aligns to the processes and principles used for the most recent DPP reset is an important and principled consideration, as it helps to promote a level of certainty for EDBs that are subject to CPPs.

Aurora's support for alignment with DPP3 reset processes should not be construed as support for an unchanged process at the next (DPP4) reset. There is growing acknowledgement among stakeholders that the largely rearward-looking approach to forecasting EDB expenditures is unlikely

1 s52A, Commerce Act 1986.

2 s53K, Commerce Act 1986.

to be fit-for-purpose going forward[3], as the nation embarks on the challenge of decarbonising the economy through greater electrification (particularly of transport and industrial process heat).

Capital expenditure reference periods

Aurora supports the use of a five-year reference period for scrutinising Powerco's capital expenditure as a reasonable application of the Commission's discretion.

In resetting for DPP3, the Commission employed a 7-year reference period to scrutinise capital expenditure allowances - an increase above the 5-year reference period used to reset the 2nd DPP in 2014. The Commission's reason for increasing the reference period was to damp out volatility in capex, observed particularly among smaller suppliers.[4] Aurora opposed that decision, noting that the extended reference period would suppress Aurora's capex allowance relative to its needs (which, at the time, were obvious to all).[5] The Commission disagreed with Aurora's views, noting that its circumstances were unique and that it intended to apply for a CPP.[6] Because of the limitations on when a CPP may be applied for, however, the practical effect of this decision for Aurora was a supressed allowance for disclosure year (**DY**) 2021, requiring overspend and incurring future penalties under the incremental rolling incentive (expenditure efficiency) scheme.

Powerco's circumstances at this transition are also unique; however, we are pleased that the Commission has applied its discretion to use a 5-year reference period to scrutinise Powerco's capital expenditure. Aurora agrees with Powerco's view that the CPP allowed it to reset its expenditure levels, rather than to catch up on historic investment.[7] In this context, the use of a 7-year reference period could supress Powerco's capex allowance below its needed level.

While catch up on investment is one of the material drivers of Aurora's CPP, the long-term resetting of expenditure allowances is, as for Powerco, also a significant factor. When we ultimately transition off our CPP, we consider that similar discretion as to the appropriate length of the capex reference period will likely be needed.

Non-network capex

Aurora has reservations about the Commission's approach to determining Powerco's non-network capex allowances. We think that with a little refinement in approach, a more robust and reasoned decision can be reached.

The Commission compared the expenditure forecasts in Powerco's 2021 asset management plan (**AMP**) and 2022 AMP update, and observed that there were unexplained uplifts in expenditure relating to ICT and facilities capex - both routine and atypical.

To deal with the unexplained uplifts, the Commission has preferred Powerco's 2021 forecasts for:

- routine ICT capex in DY2024;
- atypical ICT capex in DY2025; and
- atypical facilities capex in DY2024 and DY2025;

This results in an outcome where 2022 forecast reductions relative to Powerco's 2021 AMP are accepted, seemingly without question (that we can see from the reasons paper), and that forecast

3 Refer to submission on the Commission's process and issues paper for the 2023 input methodologies revew. Available from https://comcom.govt.nz/regulated-industries/input-methodologies/input-methodologies-for-electricity-gas-and-airports/input-methodologies-projects/2023-input-methodologies-review

4 Commerce Commission. (2019). Default price-quality paths for electricity distribution businesses from 1 April 2020 – Final decision: Reasons paper. Paragraph B90, p216.

5 Aurora Energy Limited. (2019). Aurora Energy's submission in response to the Commission's DPP3 Draft Decision. Paragraphs 6 to 11, p2-3.

6 Ibid. Paragraph B94, p217.

7 Powerco Limited. (2022). Submission - Powerco CPP-to-DPP Process and Issues. Attachment 1, p3.

increases are excluded by preferring Powerco's 2021 forecast. In our view, this is not a reasoned or evidence-based outcome.

We consider that there is merit in the Commission engaging with Powerco to require an explanation and evidence of the increase in forecast expenditure levels between DY2021 and DY2022. The Commission does not set DPPs in complete isolation and at each previous reset has issued information requests to support its deliberations. Requesting that Powerco explain and evidence its DY2022 non-network capex forecast would be consistent with normal DPP reset processes.

Other evidence-based discretion

Aurora supports the following discretion applied by the Commission, which we consider to be well-reasoned and uncontroversial:

- Using updated escalations forecasts prepared independently by NZIER:
  + LCI, PPI, and CGPI for input costs; and
  + CPI for the revenue path;
- Selection of DY2022 as the opex base-year;
- Use of Statistics New Zealand's 2021 update of its family and household projections (ICP growth proxy for opex trends);
- Use of Powerco's disclosed DY2022 line length data for opex trends;
- Use of Powerco's DY2022 financial information disclosures for financial model inputs; and
- Use of Powerco's 2022 AMP update forecasts for capital expenditure.

Use of these discretionary factors are, in Aurora's view, consistent with the relatively low-cost nature of the DPP and help to satisfy Powerco's reasonable ex-ante expectation of normal returns.

Yours sincerely

Gary Dixon
Chief Financial Officer
AURORA ENERGY LIMITED