Wellington Electricity

Cross Submission on Submissions

The Commerce Commission's 'Wellington Electricity's proposal to customise its prices to better prepare its network for an earthquake' draft decision

March 2018

Wellington Electricity's Cross Submission

1. Thank you for the opportunity for Wellington Electricity to provide a cross submission on the submissions made on the Commerce Commission's draft decision on the proposal to customise Wellington Electricity's price-quality path to allow earthquake readiness investment and cost recovery.

2. Our cross submission responds to points raised by MEUG, NZIER and Transpower in their submissions.

Cost Benefit Analysis

3. We are pleased, given the high degree of effort that was applied to the risk and engineering assessment, that NZIER's review of the cost benefit analysis (CBA) found that it was clear and proportionate to the proposed level of expenditure. We note the observation that a more sophisticated approach is expected for larger scale resilience expenditure. In this regard, we point to the Modelling the Economics of Resilient Infrastructure Tool (MERIT) analysis that is currently underway as part of the Wellington Lifelines Regional Resilience Project.

4. This MERIT project is looking to model in detail the likely damage to the regions infrastructure assets based on a combination of infrastructure damage models (which assets are likely to suffer damage at different earthquake intensity) and earthquake intensity models based on a specific earthquake scenario. It considers the inter-dependencies, such as how transport damage can impact the restoration of electricity, water and other utility supplies. Recovery times are then calculated to assess the probable extent and duration of outages.

   The MERIT model then simulates the economic impact of disrupted infrastructure by:

   - focussing on the first five years – response, recovery, not rebuild
   - analysing through time, across space and by 50+ sectors
   - modelling key economic indicators – GDP, income, trade, prices etc
   - calibrating against real world data.

   The benefit of any future resilience investments being considered can then be informed by this analysis ahead of any future price path application.

5. Transpower agreed in its submission that there are substantial unquantified benefits that are difficult to readily demonstrate for High Impact Low Probability (HILP) investments. MEUG also suggested that it would be useful to "describe the substantial unquantified benefits that it felt were delivered by the WELL CPP." We explained the substantial unquantified benefits in response to a question from Strata in its review of the CPP readiness expenditure, as detailed in Strata's letter to the Commission dated 18 December 2017, page 10:

"Whilst we did not specifically articulate the full range of unquantified benefits, both the Proposal and the Business Case were framed within this wider context. For example, section 2.1.2 of the Proposal and section 2.5 of the Business Case discussed the wider economic impacts including reference to the BERL report[1] which cited a permanent loss of GDP in the region of $30-$40 billion. Discussions with stakeholders and the subsequent letters of support clearly demonstrate that the wider social and economic benefits are well understood by our community and business leaders.

For clarity, we include the full list of unquantified benefits that we consider make up the additional benefit to that represented by the value of unserved energy, and that were referred in different places throughout the proposal and business case. In summary, these include:

- Non Quantifiable Benefits not captured by value of unserved energy;
- Emergency services – maintaining supply, or earlier restoration of supply, to emergency services (such as the hospitals in the region) will enable those services to assist people in need - hampered to the least extent manageable by power outages;
- Quality of life– water, heat, lighting, cooking, sewerage; transport, communications. It is likely that, following a major earthquake, many people will need to recover, and await assistance and replenishment of supplies, in their homes. Maintaining supply, or earlier restoration of supply, improves living and recovery conditions;
- Social stability – safety, isolation, stress;
- Business continuation;
- Government and associated departments continuation;
- Population growth or mitigating population loss;
- Investor confidence;
- Permanent GDP loss - $30-$40 billion; and
- Intention to share the spare equipment with other EDBs for use in disaster events that reduce their ability to restore power supply to their customers – this provides wider risk reduction benefits."

The resilience incentive mechanism

6. MEUG has recommended the resilience index be phased to incentivise urgent implementation for the proposed works with material deviations to be treated as breaches. We are of the view that the draft decision has very strong incentives on delivery and increasing the extent to what appears to be purely punitive measures by their nature is self-defeating to the incentive of making an additional investment.

   As noted in our submission, the quality incentive scheme is typically symmetrical where performance that is poor has a financial penalty, while performance above what is expected has a financial reward. Furthermore a two out of three

[1] "Wellington – essential to NZ's Top Tier", BERL, December 2015.

compliance occurs before a potential breach action then occurs. In the draft decision, proposed penalty of up to $5.2 million at 15% of expenditure is well above the 1% allowable revenue at risk under the current quality regime, and triggers if compliance is not reached to the target, hence the incentive is very strong for WELL to complete the work. There is no incentive to outperform the target where gains in resilience for a similar expenditure under the proposed incentive scheme.

MEUG suggested phasing of the minimum resilience index throughout each year of the period will perversely threaten the efficiency with which we can deliver the program. We are already managing both planned and reactive work programmes for our existing SAIDI and SAIFI performance through planned maintenance and investment cycles across multi-years. We do this to operate efficiently which we could not do if we were constrained to deliver specific works in single years. We are of the view that any new regime should reflect the principles of the existing regimes as closely as possible.

While the acquisition of critical spare equipment could conceivably be completed within the first year of the CPP, this would have been largely enabled through the result of the last few years of extensive line route planning, support frame development, strength testing and field trialling to ensure the correct spares are purchased. A similar start-up approach is required for mobile substations and data centres but we are at the start of this process and hence require the design and planning work to be completed ahead of tendering the construction and delivery as well as field commissioning and testing.

Similarly the seismic strengthening program will be phased over the three year period and we need to maintain operational flexibility in our delivery to avoid compromising cost and quality efficiencies, especially due to the fact that we have yet to start investigation work and detailed design.

We are of the view that MEUG's suggested approach does not recognise the activities required to complete each project. It is too rigid and would consume unnecessary time, cost and energy should a potential for a breach condition occur and investigations required rather than concentrate resources on delivering the readiness projects.

7. We do not agree with the final year index being increased from 60 to 95 and argue that the comparison with the NZX listing materiality rules is not relevant. The NZX listing materiality threshold relates to a single transaction with the 5% threshold being the proportion of an entity's consolidated asset base. It would be difficult to see how the program of readiness work would be a single transaction under these terms. While the $30 million is around 5% of our Regulated Asset Base, the cost of the individual projects are not material investments, hence MEUG's argument does not appear to be valid.

8. We are already incentivised to deliver against a resilience index of 100 at the end of the period as part of the proposed quality incentive measures. Adding an

additional breach threshold would be heavy handed and counter-productive to incentivising a broad range of readiness investment activities.

Pass through balance moving off the DPP

9. The Pass Through Balance (PTB) is designed to manage the "over and under" recovery of costs on behalf of other parties. These costs are collected by distribution companies in the price offered to retailers for final customer bill preparation. This is expected to be balanced across the five year reset period. When a change in price path occurs, it crystallises the need to deal with the PTB. MEUG's preference is for the $10 million pass-through balance of recoverable costs to be paid back in the first year of the CPP. As stated in our submission, returning this balance to consumers over three years is NPV neutral and is more in keeping with the DPP outcome which would have occurred if we had not made this customised price path application.

10. Our proposed smoothing of the return of the pass through balance over the CPP period is comparable to the recent settlement reached between Vector and the Commerce Commission which allowed Vector to return over recovery of revenue back to its consumers over the remainder of the DPP regulatory period[2].

Conclusion

11. We would like to express our thanks to everyone who has engaged with ourselves and the Commission during this process. We are pleased to have the proposal's cost benefit analysis largely endorsed by a well-respected specialist economics consultant firm such as NZIER and we take the relatively few points raised in the submission as broad support for our proposal.

12. MEUG has raised concerns with the CPP regime and whilst we have no specific comment in this regard, we are keen to continue to be part of future discussions and decision about the broader regulatory process.

Yours sincerely

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2 http://www.comcom.govt.nz/dmsdocument/15590