
Submission

Commerce Commission: Open letter requesting feedback on recent customised price-quality path processes

31 July 2018



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1 Introduction

- 1.1 Aurora Energy welcomes the Commerce Commission's (Commission) open letter "Requesting feedback on recent customised price-quality path processes" (Open Letter).
- 1.2 No part of our submission is confidential and we are happy for it to be publicly released.
- 1.3 If the Commission has any queries regarding this submission, please do not hesitate to contact:
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2 General observations and summary of response

- 2.1 Aurora Energy supports the Commission undertaking this post-determination review of the Powerco and Wellington Electricity customised price-quality path (CPP) determinations. Learnings from a similar review of the Orion process have helped improve the regime and we believe that seeking feedback is an effective way to ensure CPPs remain a viable option for electricity distribution businesses (EDBs).
- 2.2 We agree with the Commission's desire to make the CPP process as transparent as possible and support, in principle, a number of the suggestions in the Open Letter. It is important that stakeholders have confidence in an EDB's CPP proposal and that they are made aware of, and have the ability to understand, the EDB's desired outcomes. At the same time, however, the Commission should take care to ensure that regulatory requirements do not simply become additive and then become excessive or unreasonable.
- 2.3 Aurora Energy is preparing for a CPP application for submission in 2020. It is important, therefore, that any proposed changes to CPP rules and requirements are signalled as early as possible as we want to avoid having to chase a moving target.
- 2.4 Our responses to the issues set out in the Open Letter are briefly detailed in the table below and are further expanded upon in the remainder of our submission.

| ISSUE | COMMISSION'S VIEW | COMMENTS |
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| Table A – Consideration of alternatives | There is merit in a formal process for applicants to consult with third parties on alternative solutions in the development of their proposal. | <ul style="list-style-type: none">• It is important that stakeholders have the opportunity to voice their views on a proposed CPP investment plan before it is finalised for submission. This is the objective of CPP consumer consultation; a process that should start with early engagement on the underlying drivers for a CPP (some way before specific investment options and alternatives have been finalised).• We therefore support stakeholders being provided with an early indication of network investment drivers (for example information on future network constraints and demand projections) and an opportunity for them to engage with an EDB on alternatives. It is important to note though, that engagement and consideration of alternatives at the solution level might only occur during the CPP period, especially for those projects scheduled for development later in the CPP period.• We caution against introducing an approach that is too formal or mechanistic to supplement consultation on alternative solutions. The CPP verification process already assesses an applicant's proposal against the expenditure |

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| | | <p>objectives and as part of this we expect that a verifier could assess the extent to which applicants have considered appropriate alternatives and engaged with stakeholders.</p> <ul style="list-style-type: none"> • Nevertheless, it should be easy for stakeholders to engage with an EDB if they want to and stakeholders should know how and when to engage and have the right information from which to make a decision as to whether to engage. • We believe that this can be achieved by making better use of the annual asset management plans (AMP) to signal future network requirements and possible solutions that could be considered. The AMP could also clearly signal the engagement window (the indicative timing when options will be considered) and the process for engaging. The annual AMP would also summarise (for major growth and development projects) the options that had been considered and the feedback received from third parties during the assessment period. |
| Table B – Use of cost benefit analysis | <ul style="list-style-type: none"> • The evaluation criteria contained in the IMs review in 2016 is a sufficient test to determine whether a CPP consistent with the purpose of Part 4. • The application of a cost-benefit analysis (CBA) is not required to achieve this same outcome. | <ul style="list-style-type: none"> • We agree with the Commission that the CPP input methodologies (IMs) evaluation criteria is a sufficient test to determine whether a CPP is consistent with the purpose of Part 4. • We maintain the view that mandating the use of CBA in the CPP process is not necessary and has not been justified by its proponents. • While we do not agree with a CBA requirement being built into the CPP process, we do acknowledge that, when preparing a CPP proposal, considering the costs and benefits of a range of options for certain types of investments is a vital and important part of the process. • We also agree that it is appropriate for the verifier to challenge and test an applicant's options analysis both at a portfolio / programme level and overall, and to review and comment on the criteria applied to evaluate options and alternative investment scenarios. |
| Table C – Long term pricing impact | <p>CPP applicants should be required to consult with their consumers on the indicative long term price impacts of their proposals.</p> | <ul style="list-style-type: none"> • In principle we support the Commission's position that applicants should consult on the long-term price impact that a CPP proposal will have on consumers. However, we note the difficulties in predicting long term price impacts and forecasting price movement to an average consumer over a 10 to 12 year period. • Not least of which are difficulties in calculating the DPP counterfactual, difficulties in predicting future WACC and the potential impact of distribution pricing reform. • We therefore consider that providing consumers with an indication of the likely trend or possible 'envelope' of future prices is appropriate as well as explaining the future impact of any smoothing options that might be considered during the CPP period. • We would be concerned, however, if CPP application outcomes started to be driven purely by long term 'uncertain' expected price outcomes rather than on the level of prudent and efficient investment needed during the five year CPP period to safely deliver the level of services that consumers value. |
| Table D – Calculating | <p>There should be a standard approach to calculating</p> | <ul style="list-style-type: none"> • Having a standard methodology to calculate price and revenue that is applied by both EDBs in preparing their CPP |

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| revenue and pricing changes | revenue and price changes to be used by both CPP applicants and the Commission for application to both CPP and default price-quality paths. | <p>proposal, and the Commission in determining a CPP proposal, would be beneficial and this was an issue that emerged late on in the Powerco CPP process. Aurora Energy welcomes the opportunity to input to the Commission's review of options in this regard.</p> <ul style="list-style-type: none"> • Again we caution against attempting to be too precise in how prices are calculated and signalled given the uncertainties noted above, the use of averages and the sensitivity of price outcomes to factors such as prevailing interest rates (the Commission having stated in the Open Letter that "<i>the outcome of this proposed approach enables applicants and us to ... express \$ price increases or decreases (to the nearest 10 cents)</i>")¹) • We are concerned too with the Commission drawing solely on the Ministry of Business, Innovation and Employment's (MBIE) notion of a "<i>typical consumer</i>" as we do not believe that this accurately reflects a network's consumer base. We recommend that the Commission engages further with ENA on this. • Using a point estimate of 'average price', in Aurora Energy's case, would result in inaccuracies and a misleading outcome given the fact that we have three material pricing regions, each with their own unique consumption characteristics. |
| Table E – Delivery and accountability of CPP commitments | A CPP applicant should propose measures that are closely linked with the key drivers of its proposal to establish greater accountability. | <ul style="list-style-type: none"> • We recognise the need for transparency and for stakeholders to remain up to date, and for EDBs to remain accountable, during the CPP period through stakeholder-facing reports. • We firmly believe, however, that any framework for stakeholder-facing reports needs to be sufficiently flexible so as to allow the CPP applicant to vary the exact timing and delivery of the investment or expenditure that it is proposing. The CPP process is designed with such flexibility in mind and this should not be undermined. • For the rationale outlined below we do not think it is appropriate for the Commission to mandate the inclusion of additional quality measures, as we believe there is sufficient accountability in the proposed stakeholder-facing delivery reports. • Refer also to Table F response below. |
| Table F – Link between price and quality | Asset management is one of the Commission's priorities for the electricity sector and would like to better understand how an asset criticality framework could be adopted to support CPP proposals. | <ul style="list-style-type: none"> • We agree with the Commission's general comment that "<i>where there is a direct link between price and quality, it is easier for the consumers to make their preferences clear</i>"². Where there is a direct link then EDBs should draw this out and make this explicit in a CPP application and during consultation. • Like most EDBs, Aurora Energy is focusing on developing its asset criticality framework and developing its understanding of the impact of specific expenditure and interventions on quality. We believe that it is too early on in the process to consider regulating in this space until practices have had more of an opportunity to develop. |

¹ Commerce Commission. (2018). Open letter, Requesting feedback on recent customised price-quality path processes, 3 July 2019, paragraph 14 of Attachment B.

² Commerce Commission. (2018). Open letter, Requesting feedback on recent customised price-quality path processes, 3 July 2019, Table F.

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| | | <ul style="list-style-type: none"> • We note that the Commission has stated its priority to work with the industry to ensure that asset management practices are matured and this includes the development and evolution of quality metrics and their linkage to investment. • We recommend and support this process continuing, including placing requirements on EDBs to report on progress in these areas. We do not support mandating, at this stage, new requirements on EDBs to demonstrate explicit linkages between investment and precise quality outcomes, other than at an overall investment scenario level. |
| Table G – Consumer consultation | <ul style="list-style-type: none"> • The Commission is not convinced that Powerco's consumer engagement was as meaningful as it could be, or had a meaningful impact on its proposal. • Powerco's engagement could have provided more detail and/or optionality and better articulated the price and quality trade-offs of different options on the typical household bill. • The Commission should explore ways in which the consumer consultation can be improved ahead of further CPP applications. | <ul style="list-style-type: none"> • As noted, we fully support the need to provide stakeholders with opportunities to voice their views, for their preferences to be heard and to have an influence on EDBs' investment decisions and proposals. • Lifting stakeholder engagement is a key priority for Aurora Energy both day to day and in the lead in to our CPP application in 2020. • Powerco's CPP consultation process was independently acknowledged to be comprehensive and following best practice. Despite this, the level of actual end-consumer engagement in the process was low. In our view, the Commission's interpretation of previous consultations is overly simplistic, including an incorrect conclusion that a perceived lack of engagement during the Powerco process was due to a deficiency in the information made available by Powerco. • It probably more reflects the complexity of the issues being consulted on and the level of interest that time poor members of the public generally have in engaging on electricity network works planning issues. This needs to be recognised and consultation expectation revised accordingly. • Aurora Energy's recommendation is that engagement / consultation and consumers' interests could be supported in a number of ways: <ol style="list-style-type: none"> 1. General public: should be provided early information and an ongoing opportunity to engage. At a high level the CPP applicant should be required to explain the investment proposed, the outcomes being sought and the price implications of different scenarios. 2. 'Interested' stakeholders: parties with greater interest in both technical and commercial aspects of an EDB's CPP proposal should have access to more detailed information and opportunities to engage directly with the applicant on meaningful issues (without a need for high volumes of generalised documentation). 3. Independent verifier: can assess whether certain, larger investments have had sufficient options analysed, including whether these options have been adequately explained to impacted stakeholders. • More broadly, the Commission should provide explicit direction on what it considers to be appropriate consumer engagement more generally under both a DPP and CPP. It creates a risk to EDBs if it remains unclear where the |

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| | | Commission will set the hurdle as to what constitutes effective consultation. |
| Table H – Verification | The Commission considers the verification process for Powerco to be successful. | <ul style="list-style-type: none"> • The outcome of the Powerco CPP demonstrates that the current verification process provides a robust model for the verification process. • We are comfortable with the verifier releasing an emerging views or preliminary report, provided only that the EDB has been given the opportunity to check facts and challenge the draft report prior to release. |
| Table I – Defining and applying proportionate scrutiny | <ul style="list-style-type: none"> • The principle of proportionate scrutiny is sufficiently defined within the current CPP requirements. • By its nature, it is difficult to provide a definitive codified definition of how the principle of proportionate scrutiny will be universally applied. • The Commission considers it important that the principle should not be used as a lever for potential applicants to limit or attempt to control the scope of assessing a CPP application. | <ul style="list-style-type: none"> • Proportionate scrutiny is an important principle in the application of the Commission's Part 4 responsibilities. • We agree that scrutiny of CPP proposals needs to be proportionate and believe that the Commission needs to take care not to apply a binary standard in the application of the principle. • Formulating guidelines which clarify the principle, and providing stylised examples of how the Commission will apply the principle, would be useful to a CPP applicant. |

3 Table A: Consideration of alternatives

- We support stakeholders being provided with an early indication of network investment drivers and an opportunity for them to engage with an EDB on alternatives.
- We caution against introducing too formal an approach to additional consultation on alternative solutions.
- We believe that easier stakeholder engagement can be achieved by making better use of the AMPs to signal future network requirements and possible solutions that could be considered.
- **What is an appropriate threshold to require market testing?** We do not consider a prescribed threshold to be appropriate, however, we would ourselves signal to the market major growth and development projects.
- **What information and processes should be required for market testing?** AMPs are a good starting point for signalling investment projects. The Commission could consider how better use can be made of them to signal future network requirements.
- **When should the market testing be conducted?** We believe early engagement will be critical to the success of a CPP application.

- 3.1 The Commission has made it clear that it considers there is merit in a formal process for applicants to consult with third parties on alternative solutions in the development of their CPP proposals.
- 3.2 We believe that it is important that stakeholders have the opportunity to voice their views on a proposed CPP investment plan before it is finalised for submission and to that end support stakeholders being provided with signals of network investment drivers (for example

information on future network constraints and demand projections) and an opportunity for them to engage with an EDB on alternatives. Note that engagement and consideration of alternatives at the solution level might only occur during the CPP period especially for those projects scheduled for development later in the CPP period.

- 3.3 We caution against introducing an approach that is too formal or mechanistic to supplement consultation on alternative solutions. The CPP verification process already assesses an applicant's proposal against the expenditure objectives and as part of this we expect that a verifier could assess the extent to which applicants have considered appropriate alternatives and engaged with stakeholders.
- 3.4 Nevertheless, it should be easy for stakeholders to engage with an EDB if they want to and stakeholders should know how and when to engage and have the right information from which to make a decision as to whether to engage.
- 3.5 We believe that this can be achieved by making better use of the annual AMPs to signal future network requirements and possible solutions that could be considered. The AMP could also clearly signal the engagement window (the indicative timing when options will be considered) and the process for engaging. The annual AMP would also summarise (for major growth and development projects) the options that had been considered and the feedback received from third parties during the assessment period.
- 3.6 We acknowledge that early consultation and engagement with all of our stakeholders will be critical to the success of a CPP application and that such consultation and engagement will extend to testing the market to actively assess alternative options for defined projects.

4 Table B: Use of CBA

- We agree with the Commission that the CPP IM evaluation criteria is a sufficient test to determine whether a CPP is consistent with the purpose of Part 4.
- **Areas of potential CPP proposals that could be the focus of further work to understand how benefits can be quantified?** Considerations for further focus would be assisted by a common consistent framework for monetised consequences and risks.
- **How an asset criticality framework could help support identifying expected benefits of additional expenditure?** Asset criticality is still very much an emerging discipline in the New Zealand distribution sector and requires time to mature and develop before it is known how it could help achieve this purpose.
- **Are there potential changes to the CPP requirements that could help support the use of CBA as a tool to inform CPP proposals?** No, we do not believe that further regulation is required in relation to the use of CBAs in the CPP process. We also note that an applicant may use CBA if appropriate, and that the Commission and an independent verifier may request it as part of their review.

- 4.1 We agree with the Commission that the CPP IM evaluation criteria, consulted on as part of the IMs review in 2016, is a sufficient test to determine whether a CPP is consistent with the purpose of Part 4. Proponents have not explained or demonstrated why existing CPP requirements are inadequate to enable the Commission to make a CPP determination. Nor have they justified the mandatory use of a CBA.
- 4.2 We do not agree with an explicit requirement within the IMs to use CBA.
- 4.3 As a part of preparing a CPP proposal, an EDB will need to consider the costs and benefits of a range of options and then ultimately decide on what is the best fit for the specific outcomes it desires. CBA based analysis can lead to binary decisions around the merits or otherwise of investments. This approach is particularly unsuitable for certain expenditure, for example reactive replacement. The EDB is best placed to determine where in its proposal it needs to consider the costs and benefits.

- 4.4 We also agree that it is appropriate for the verifier to challenge and test an applicant's options analysis both at a portfolio / programme level and overall, and to review and comment on the criteria applied to evaluate options and alternative investment scenarios.
- 4.5 If a decision is made to approve the EDB's CPP application, then, as we have already seen with Powerco (and with which we in principle agree), these investment decisions will be backed by stakeholder facing delivery reports to help ensure accountability in terms of expected benefits and outturn costs.
- 4.6 Asset criticality is an area which is still immature and developing within the New Zealand distribution sector. We do not believe that it is sufficiently developed yet throughout the industry to consider regulating at this stage.

5 Table C: Long term pricing impact

- **Should an applicant be required to consult on the long term price impact of its proposal?** We agree in principle that CPP applicants should consult on the long-term price impact that a CPP proposal will have on consumers. In the preparation of our own CPP proposal we plan to engage in meaningful consumer consultation on this issue.

However, there are inherent difficulties in predicting the long term price impacts (the difficulty in calculating the DPP counterfactual, difficulties in predicting future WACC and the potential impact of distribution pricing reform). The Commission should look to consider the options available to a CPP applicant to reliably calculate those impacts and set some guidelines.

- **Is an input methodology amendment appropriate?** We believe it is if the Commission considers that EDBs should be required to consult on the long-term price impact of its proposal.

- 5.1 We recognise that for consumer consultation and engagement to be effective, consumers need to be well informed of the impact of the potential CPP on prices. For this reason we agree with the Commission that it would be beneficial for EDBs to consider the long term pricing impact of its CPP and the investments made under it and to engage with consumers on those impacts when preparing a CPP proposal.
- 5.2 However, as the Commission has already itself acknowledged, "*there is significant uncertainty around the extent of the subsequent price increase*"³. It is difficult for an EDB to calculate the DPP counterfactual given the impact that interest rates have on WACC. The distribution sector is also considering significant pricing reform in the near future which may have an impact on the ability to effectively communicate the long-term price impacts.
- 5.3 Therefore, while we agree with the Commission on the merits of consulting on the long-term pricing impacts (which the Commission itself suggests may be "*indicative*"⁴), we consider that providing consumers with an indication of the likely trend or possible 'envelope' of future prices is appropriate, as well as explaining the future impact of any smoothing options that might be considered during the CPP period.
- 5.4 We would be concerned if CPP application outcomes started to be driven purely by long term 'uncertain' expected price outcomes rather than on the level of prudent and efficient investment needed during the five year CPP period to safely deliver the level of services that consumers value.
- 5.5 If the Commission is going to further pursue a requirement on EDBs to consult on the long term price impact of its proposal then we believe that an amendment to the IMs will be necessary.

³ Commerce Commission. (2018). Open letter, Requesting feedback on recent customised price-quality path processes, 3 July 2019, Table C.

⁴ Commerce Commission. (2018). Open letter, Requesting feedback on recent customised price-quality path processes, 3 July 2019, Table C.

6 Table D: Calculating revenue and pricing changes

- **Are there any issues in using a standard approach to calculating revenue and price changes consistently for consumer consultation purposes as well as in the CPP decisions?** Having a standard methodology to calculate price and revenue that is applied by both EDBs in preparing their CPP proposal and the Commission in determining a CPP proposal would be beneficial. We do, however, caution against attempting to be too precise in how prices are calculated and signalled.
- **Whether the proposed approach to calculating these changes and the assumptions that are made as outlined in Attachment B are appropriate?** We are concerned with the Commission using a point estimate of 'average price' which, in Aurora Energy's case, would result in inaccuracies and misleading outcomes given the fact that we have three material pricing regions, each with their own unique consumption characteristics.
- **Whether focusing the analysis on the 'typical consumer' as outlined in Attachment B is appropriate?** We are concerned with the Commission drawing solely on MBIE's notion of a "typical consumer" as we do not believe that this accurately reflects a network's consumer base and recommend the Commission engages further with ENA on this point.
- **Whether there are any other relevant consumer types that should be included in this analysis and, if included, where the necessary information could be sourced from?** We believe that the reliance solely on MBIE's "typical consumer" does not accommodate large commercial and industrial consumers.

- 6.1 The Commission has stated that "There is no established methodology for calculating and communicating price changes relating to customised price-quality proposals and decisions"⁵ and considers that "there should be a standard approach to calculating revenue and price changes to be used by both customised price-quality path applicants and the Commission"⁶.
- 6.2 We agree that having a standard approach would be beneficial and support this, provided that the approach is set in advance of an EDB taking steps to prepare its CPP proposal. This will ensure that the EDB is able to carry out early consumer engagement on revenue and price changes in the knowledge that it is doing so using the same methodology that will then later be applied by the Commission in determining the CPP application.
- 6.3 Again, we caution against attempting to be too precise in how prices are calculated and signalled given the uncertainties noted above, the use of averages and the sensitivity of price outcomes to factors such as prevailing interest rates (the Commission having stated in the Open Letter that "the outcome of this proposed approach enables applicants and us to ... express \$ price increases or decreases (to the nearest 10 cents)"⁷).
- 6.4 Table L on page 16 of the Open Letter uses a point estimate of 'average price' in those instances where the CPP applicant has more than one region that corresponds to its network. We believe that a more appropriate method of calculating this would be by taking a weighted average of pricing areas. In Aurora Energy's case (where three material pricing regions, each with their own individual consumption characteristics, exist on the network), using a point estimate taken by inspection would overstate the position because 65% of Aurora Energy's residential consumers are based in the Dunedin pricing area. A weighted average across the three pricing areas would give a much more reliable figure to then apply in the calculation.

⁵ Commerce Commission. (2018). Open letter, Requesting feedback on recent customised price-quality path processes, 3 July 2019, Table D.

⁶ Commerce Commission. (2018). Open letter, Requesting feedback on recent customised price-quality path processes, 3 July 2019, Table D.

⁷ Commerce Commission. (2018). Open letter, Requesting feedback on recent customised price-quality path processes, 3 July 2019, paragraph 14 of Attachment B.

- 6.5 We agree that the exclusion of pass-through and recoverable costs is reasonable.
- 6.6 We believe that there are inherent difficulties in relying solely on a “*typical consumer*” as identified by MBIE for the purposes of calculating revenue and price changes. Such a consumer is a typical residential consumer consuming 8000kWh per year. This notion does not take into account large commercial and industrial consumers on a network whose consumption is quite different to that of MBIE’s “*typical consumer*”.

7 Table E: Delivery and accountability of CPP commitments

- **Does there need to be improved transparency that demonstrates a CPP applicant is delivering the commitments for which it has been funded in a transparent and easily understandable way?** Yes, we believe that there is room for transparency to be improved and that the framework adopted by Powerco achieves this.
- **Should an applicant be required to provide a stakeholder facing delivery report that sets out how it is delivering the major projects and wider commitments it has been funded for under a CPP?** We believe that stakeholder-facing delivery reports achieve the aim of making the CPP process more transparent to stakeholders.

We do firmly believe, however, that any framework for stakeholder-facing delivery reports needs to be sufficiently flexible so as to allow the CPP applicant to vary the exact timing and delivery of the investment or expenditure it is proposing and that the Commission should not take a rigid and inflexible approach to these.
- **Is it appropriate to require CPP applicants to propose additional quality measures that are closely linked with the key drivers of its proposal to establish greater accountability for increased revenue, and whether these should be linked with revenue?** For the reasons outlined in section 8 below, we do not think it is appropriate for the Commission to mandate the inclusion of additional quality measures.

- 7.1 We acknowledge that the Commission has a desire for transparency to be improved and in principle agree that a way of achieving that desired transparency is through a successful CPP applicant producing and publishing stakeholder-facing delivery reports periodically during the CPP period.
- 7.2 We do firmly believe, however, that any framework for the delivery of such reports needs to be sufficiently flexible to allow the CPP applicant to vary the exact timing and delivery of the investment or expenditure it is proposing in its CPP. No projection of timing of expenditure can reasonably be expected to be 100% accurate in practice without an extremely rigid and likely imprudent (due to changing circumstances) approach to expenditure.
- 7.3 It is important that the Commission does not attempt to become too sophisticated in its requirements too soon. This is particularly so in the area of asset criticality, which we discuss further in section 8 below.

8 Table F: Link between price and quality

- We agree with the Commission’s general comment that “*where there is a direct link between price and quality, it is easier for the consumers to make their preferences clear*”⁸. Where there is a direct link then EDBs should draw this out and make this explicit in a CPP application and during consultation.
- We believe it is too early to consider the use of asset criticality (or other overarching frameworks) to link price and quality for individual investments. While there may be

⁸ Commerce Commission. (2018). Open letter, Requesting feedback on recent customised price-quality path processes, 3 July 2019, Table F.

merit in considering these, as sector capability matures, attempts to do so before common understandings and approaches are developed would likely be counterproductive. We note there are a number of differing 'asset health' approaches currently being used by EDBs, despite alignment work by Electricity Engineers Association (EEA) and the availability of guidelines and models (for example based on condition-based risk management).

- **What is the current practice within the sector for making decisions on investment trade-offs, and communicating trade-off decisions?** In our view, current practice will vary significantly within the sector due to varying capabilities, quality of asset information available to individual EDBs, and differing investment mixes. The ability of an EDB to communicate trade-off decisions will depend on the maturity of its practice and the type of investments being undertaken. As a result, any attempt to implement a sector-wide framework would be difficult, due to a need to adequately account for these differences.
- **What are the potential compliance costs of implementing an asset criticality framework?** In the absence of any 'strawman' for a framework, it is too early to be able to quantify any potential costs.
- **What is preventing asset criticality from being implemented across the sector?** If it has not done so previously, we suggest the Commission consider how asset health capability has developed across the sector, and to engage with the EEA to understand their experience in seeking to implement a sector wide framework.
- **How do price and quality trade-offs get communicated to consumers so they can more meaningfully engage?** Our approach to consumer consultation is discussed in section 9 below.

- 8.1 As we have already mentioned above, asset criticality is a developing area with widely varying capability within the New Zealand distribution sector. Until common practices and frameworks have been agreed the Commission should not contemplate mandating the use of a uniform approach within CPP applications, either to make decisions on investment trade-offs or to communicate those trade-off decisions to stakeholders.
- 8.2 The Commission's work to date on asset criticality has itself been conceptual in nature and appears to be in a developmental phase.
- 8.3 In terms of communicating price and quality trade-offs to consumers, this will be undertaken by us in our CPP proposal during consumer consultation which is discussed further in section 9 below.
- 8.4 We are also conscious that not all investments under a CPP will have the same impacts on quality and that a blanket approach to linking price with quality would not be desirable until the area is further developed and a greater understanding is had by the New Zealand distribution sector.

9 Table G: Consumer consultation

- We fully support the need to provide stakeholders with opportunities to voice their views, for their preferences to be heard and to have an influence on EDBs' investment decisions and proposals.
- Lifting stakeholder engagement is a key priority for Aurora Energy both day to day and in the lead in to our CPP application in 2020.
- We do not want to see a continuation of EDBs spending "*considerable time and effort on their consumer engagement*" which meet the IMs requirements, but for the Commission to be dissatisfied with the outcome.
- The Commission should provide explicit direction on what it considers to be appropriate consumer engagement more generally under both a DPP and CPP. It

creates a risk to EDBs if it remains unclear where the Commission will set the hurdle as to what constitutes effective consultation.

- **Is a process required to align expectations between the Commission and applicant prior to consultation being undertaken?** In the absence of the Commission preparing guidelines for EDBs, then, yes, we believe a process is required to align these expectations.
- **What is the role of specific tools such as consumer panels?** As part of the Commission's development of consultation guidelines, it should consider a wide range of possible tools. Specific tools will fulfil certain roles and these should be firmed up or discussed as a part of the consultation process to develop the guidelines.
- **Is there scope for specifying the existing requirements to provide further clarity?** We are mindful that the Commission has voiced concern about the nature of consumer consultation and engagement that has been undertaken during the preparation of the previous CPP applications. We believe, that the most productive things for the Commission to consider are prior engagement with an applicant as suggested, and to issue guidelines that articulate its expectations when it comes to undertaking meaningful consumer consultation.
- **What is the role of incentives for improving consumer engagement to get better long-term outcomes for consumers?** In terms of the role of incentives aimed at improving consumer engagement, we need to see, and have the opportunity to consider, any proposed framework and explanation from the Commission as to the incentives that it proposes and the potential revenue at risk. We do not believe that the Commission has gone far enough in addressing these points in the Open Letter for us to fully consider the role that they may play.

- 9.1 Aurora Energy considers engagement with consumers on CPP proposals to be an important part of the CPP proposal development process. We recognise the need to provide consumers with opportunities to voice their views, for their preferences to be heard, and be able to influence EDBs' investment decisions and proposals. This engagement needs to happen early in the CPP proposal process in order for it to be meaningful.
- 9.2 We support the retention of high level requirements that *"provide applicants with flexibility in how they engage with their consumers, recognising there is likely no 'one size fits all' solution"*⁹.
- 9.3 We do believe that the Commission needs to be prepared to make a clear statement to the industry about what its expectations are in terms of consumer consultation. We do not want to see a continuation of EDBs spending *"considerable time and effort on their consumer engagement"*¹⁰, which meet the IMs requirements, but for the Commission to be dissatisfied with the outcome, as was the case with Orion's CPP and Powerco's CPP.
- 9.4 Powerco's CPP consultation process was independently acknowledged to be comprehensive and following best practice. Despite this, the level of actual end-consumer engagement in the process was low. In our view, the Commission's interpretation of previous consultations is overly simplistic, including an incorrect conclusion that a perceived lack of engagement during the Powerco process was due to a deficiency in the information made available by Powerco
- 9.5 It probably more reflects the complexity of the issues being consulted on and the level of interest that time poor members of the public generally have in engaging on electricity network works planning issues. This needs to be recognised and consultation expectation revised accordingly.
- 9.6 Aurora Energy's recommendation is that engagement / consultation and consumers' interests should be addressed in a number of ways:

⁹ Commerce Commission. (2018). Open letter, Requesting feedback on recent customised price-quality path processes, 3 July 2019, Table G.

¹⁰ Commerce Commission. (2018). Open letter, Requesting feedback on recent customised price-quality path processes, 3 July 2019, Table G.

- (a) **General public:** We fully support a view that it is important that all consumers of electricity on an EDB's network (residential and commercial) have an opportunity to engage in the CPP process and have relevant information presented to them at different stages during the process and via appropriate communication channels.

At a high level, the CPP applicant should be required to explain the investment proposed, the outcomes being sought and the price implications of different scenarios (as was the case in the Powerco consultation).

The EDB needs to make it easy for consumers to engage, including the use of public forums, digital media and focus groups, but expectations should be clear that most consumers will not want to engage and we would expect the Commission and/or advocacy groups to act in their interests and engage on their behalf.

We support the use of consumer surveys at an early stage in the CPP process to help inform a willingness to pay and value preferences of different consumer groups.

- (b) **'Interested' stakeholders:** There will be parties with an appropriately greater interest in both technical and commercial aspects of an EDB's CPP proposal. Consultation here should be focused on providing more detailed information to explain different aspects of the CPP and opportunities for these parties to both come together to discuss issues and have an opportunity to engage directly with the company (perhaps using open clinics similar to members of parliament). The EDB should be incentivised to focus more on meaningful engagement than on producing high volumes of documentation. Referencing our earlier comment, the complexity associated with articulating direct price-quality trade-offs, even to an informed group, should not be underestimated and this needs to be factored in to the Commission's principle of proportionate scrutiny.
- (c) **Independent verifier:** It is also important to acknowledge that the independent verifier undertakes an important assessment role on behalf of the Commission and consumers when assessing an EDB's investment proposal against the expenditure objective and can assess whether certain, larger investments have had sufficient options analysed, including whether these options have been adequately explained to impacted stakeholders.

- 9.7 There may be scope for the Commission to work collaboratively with ERANZ and the ENA to provide greater guidance about what it considers is needed for effective engagement by producing guidelines for EDBs to use. In the absence of guidelines then the Commission should ensure, as it suggests in the Open Letter, that its expectations are aligned with an EDB's at the very beginning of the EDB planning its CPP proposal by engaging with the CPP applicant in those early stages to agree on what consumer consultation will entail. The Commission will need to accept the outcomes of that process as the agreed consultation plan for that particular CPP and be prepared to stand by it during the CPP determination process.
- 9.8 More broadly, the Commission should provide explicit direction on what it considers to be appropriate consumer engagement more generally under both a DPP and CPP. It creates a risk to EDBs if it remains unclear where the Commission will set the hurdle as to what constitutes effective consultation.
- 9.9 The Australian Energy Regulator is currently trialling an early engagement approach which includes a requirement for EDBs to consult on high level expenditure.¹¹ We see merit in this and plan on doing so during the preparation of our CPP proposal. This will see us shortly engaging focus groups that will range on topics such as our AMP and our independent review. We would expect most CPP applicants to do this as a part of preparing their CPP proposal.
- 9.10 Finally we would support greater emphasis being placed on 'early CPP engagement'. By this we mean engagement on overall drivers, priorities and AMP challenges some way before a CPP investment proposal takes shape.

¹¹ <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/regulatory-innovation>

10 Table H: Verification

- **Is the present verifier flexibility sufficient and should the verifier be required to signal early in the verification process the projects and programmes that they intended to verify?** The outcome of the Powerco CPP demonstrates that the current verification process provides a robust model for the verification process and we do not have any concerns with a verifier signalling early in the verification process those projects and programmes that it intends to verify.
- **Should the Commission be more prescriptive about the extent of the material required for the verified projects and programmes?** We believe that the current requirements in the IMs are sufficiently prescriptive to still enable them to be flexible enough and adaptive to each CPP proposal as required and are wary of further prescription in this area. This coupled with the Commission's ability to request additional material means, in our view, that further regulation is not required.
- **Is there a need to formalise the applicant information provision requirements to ensure information is provided to the verifier in a timely manner?** No, we do not believe that this is necessary.
- **Does a verifier emerging view paper or preliminary report have merit?** Yes, but only to the extent that the EDB has the opportunity to check facts and challenge the draft report prior to release.
- **Is the boundary between the audit and verification processes sufficiently clear, and if not, how can they be improved?** We consider that the audit requirements are too open-ended which could potentially lead to overlap between the two processes. We do not believe this is an issue, however, for the independent verification process.
- **Have the changes to the verification process, made during the last IMs review, improved the verification and Commission CPP assessment processes?** In general, our view is that the changes are useful and of benefit to EDBs. We believe that this is evident in the outcome of the Powerco CPP which demonstrates that the current verification process provides a robust model for the verification process.

- 10.1 We believe that an effective verification process will limit the amount of work that the Commission needs to undertake when assessing a CPP proposal. The verifier should be required to articulate the extent to which the applicant's proposal meets the expenditure objective and should identify any non-conforming elements. The Commission should then be able to rely on the verification report and focus its attention on the unverified elements of the proposal in the knowledge that the proposal has been independently tested and challenged before being submitted.
- 10.2 We strongly believe that it is not appropriate for the Commission's advisors to need to validate verified components on the proposal unless the advisors have expertise related to the verified components that the verifier does not. We believe that this situation would very rarely arise.
- 10.3 An applicant does not undertake a CPP application lightly. It is a costly process requiring a significant workload on the part of the applicant. We believe that these factors in themselves drive an applicant to ensure that it is preparing its proposal in the most efficient manner and that this extends to the timely provision of information to the verifier. We do not see a need for the information provision requirements to be formalised.
- 10.4 If a verifier emerging view paper or a preliminary report is to be presented to the Commission by the verifier, then we would expect to be able to check the facts of, and challenge, the draft report prior to it being released. Such a report would be prepared before the verifier had the opportunity to fully complete its verification process and some of the conclusions drawn in it may be inaccurate and could have a potential negative impact on the success of the CPP application if the EDB was unable to have its say at that stage.

11 Table I: Defining and applying proportionate scrutiny

- Proportionate scrutiny is an important principle in the application of the Commission's Part 4 responsibilities.
- We agree that scrutiny of CPP proposals needs to be proportionate and believe that the Commission needs to take care not to apply a binary standard in the application of the principle.
- **What is our view regarding the current definition of proportionate scrutiny and do we consider this is sufficient and provides enough clarity to potential CPP applicants?** We believe that this could be clarified further by the Commission.
- **Do we believe that there is a need for the Commission to better define the principle of proportionate scrutiny and the circumstances when it may be applied in practice?** Yes, we believe that there is a need for the Commission to do this and to provide stylised examples of how the Commission will apply the principle.
- **Are there any further steps that we think could be taken by the Commission to provide more certainty to all industry participants and stakeholders about how CPP applications will be assessed?** Formulating guidelines which clarify the principle, and which could encompass the stylised examples mentioned above, would be useful to a CPP applicant.

- 11.1 Aurora Energy considers proportionate scrutiny to be an important principle in the application of the Commission's Part 4 responsibilities. We agree that scrutiny of CPP proposals needs to be proportionate and believe that the Commission needs to take care not to apply a binary standard in the application of the principle.
- 11.2 We think that it would be useful for the Commission to clarify the definition of the principle and the circumstances in which it may be applied. In such an instance, it would be useful if the Commission could provide examples of how the principle would be applied in practice. Such examples may extend to how it would be applied in the context of the verification process and how it is applied in light of information supplied during a CPP. This would provide clarity to the industry as to the application of the principle. A clear explanation from the Commission on how CPPs are assessed and determined and the role that proportionate scrutiny plays in that assessment and determination would be welcomed.
- 11.3 We acknowledge that this is an area where the Commission should be afforded flexibility in applying the principle. We believe that this would be in the best interests of EDBs given that every CPP application will be different and that the principle should therefore be applied on a case-by-case basis. In saying this however, we believe that the Commission should demonstrate how and when it is applying the principle in order for the process to remain transparent and for EDB's to begin to better understand the ways in which the principle will be applied.

12 Changes made during the IMs review

- 12.1 In general, our view is that each of the previous changes that were identified by the Commission in the Open Letter are useful and of benefit to EDBs. In particular the adoption of a single WACC has gone some way to eliminating potential barriers to CPP applicants and that this levelling of the WACC has been helpful.