

2020–2025 price-quality paths for EDBs and Transpower

Draft decisions

29 May 2019

Sue Begg, Deputy Chair



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Outline of presentation

Highlights

- Key revenue figures
- The WACC effect

EDB DPP3

- Overview
- Quality
- Capex
- Opex
- Incentives and reopeners

Transpower RCP3

- Overview
- Quality
- Base Capex
- Opex
- Asset management & customer consultation

Overall allowed revenues in year one

Electricity distributors

\$1.04b

Down **\$50m (4.6%)** from 2019/20

Transpower

\$842m

Down **\$87m (9.4%)** from 2019/20

Note

- EDB figures do not include pass-through and recoverable costs
- Powerco and Wellington Electricity are not included in the electricity distribution figure as they are subject to customised price-quality paths



The WACC effect

- The draft decisions assume a draft WACC of 5.13%, which is the WACC recently determined for information disclosure.
- This is a change from 7.19% in the current period.
- A new WACC will be determined in October but we expect it to be in the order of the information disclosure WACC.



DPP draft decision



Background

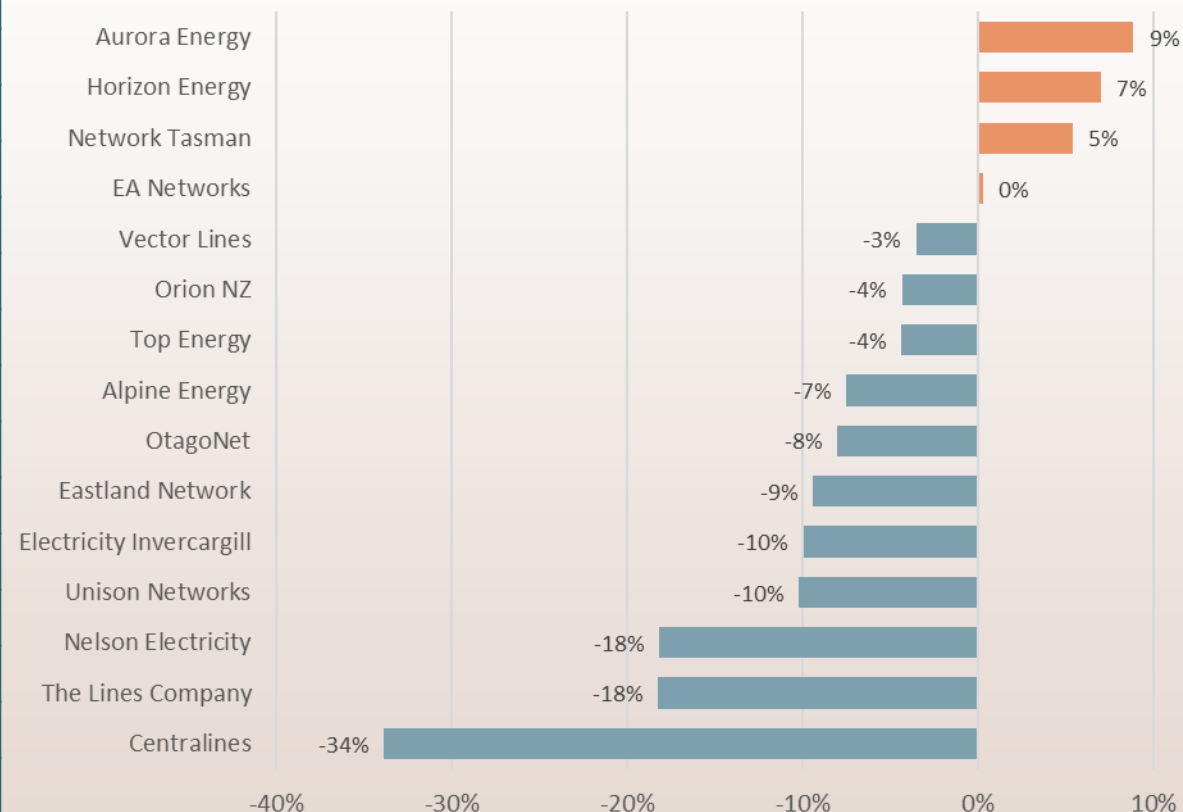
- Same core components as the current DPP2 price-quality framework
- Refinements to improve outcomes for consumers and certainty for businesses
- Applies a revenue cap to the EDB DPP for the first time
- The DPP is intended to be relatively low-cost and may not cater for every eventuality, uncertainty or specific need of an EDB



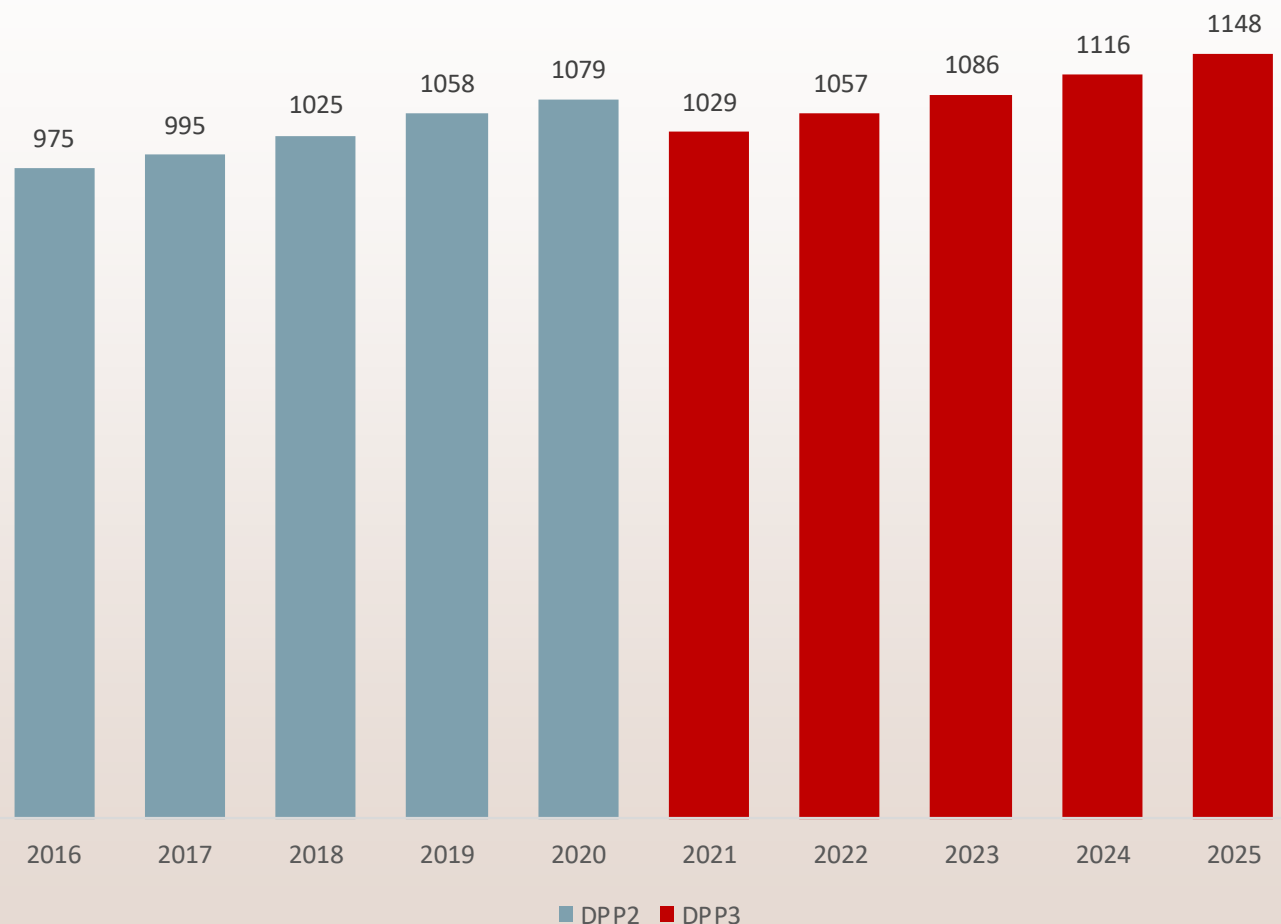
Revenue by EDB and rates of change

Distributor	Allowable revenue in 2020/21 (\$m)	Rate of change (CPI+X)
Alpine Energy	45.36	—
Aurora Energy	72.03	8.9%
Centralines	9.40	—
EA Networks	37.70	—
Eastland Network	25.06	—
Electricity Invercargill	12.29	—
Horizon Energy	25.01	—
Nelson Electricity	5.59	—
Network Tasman	28.78	—
Orion NZ	161.17	—
OtagoNet	25.08	—
The Lines Company	33.94	—
Top Energy	42.19	—
Unison Networks	102.25	—
Vector Lines	403.35	—

Change in allowable revenue between 2019/20 and 2020/21



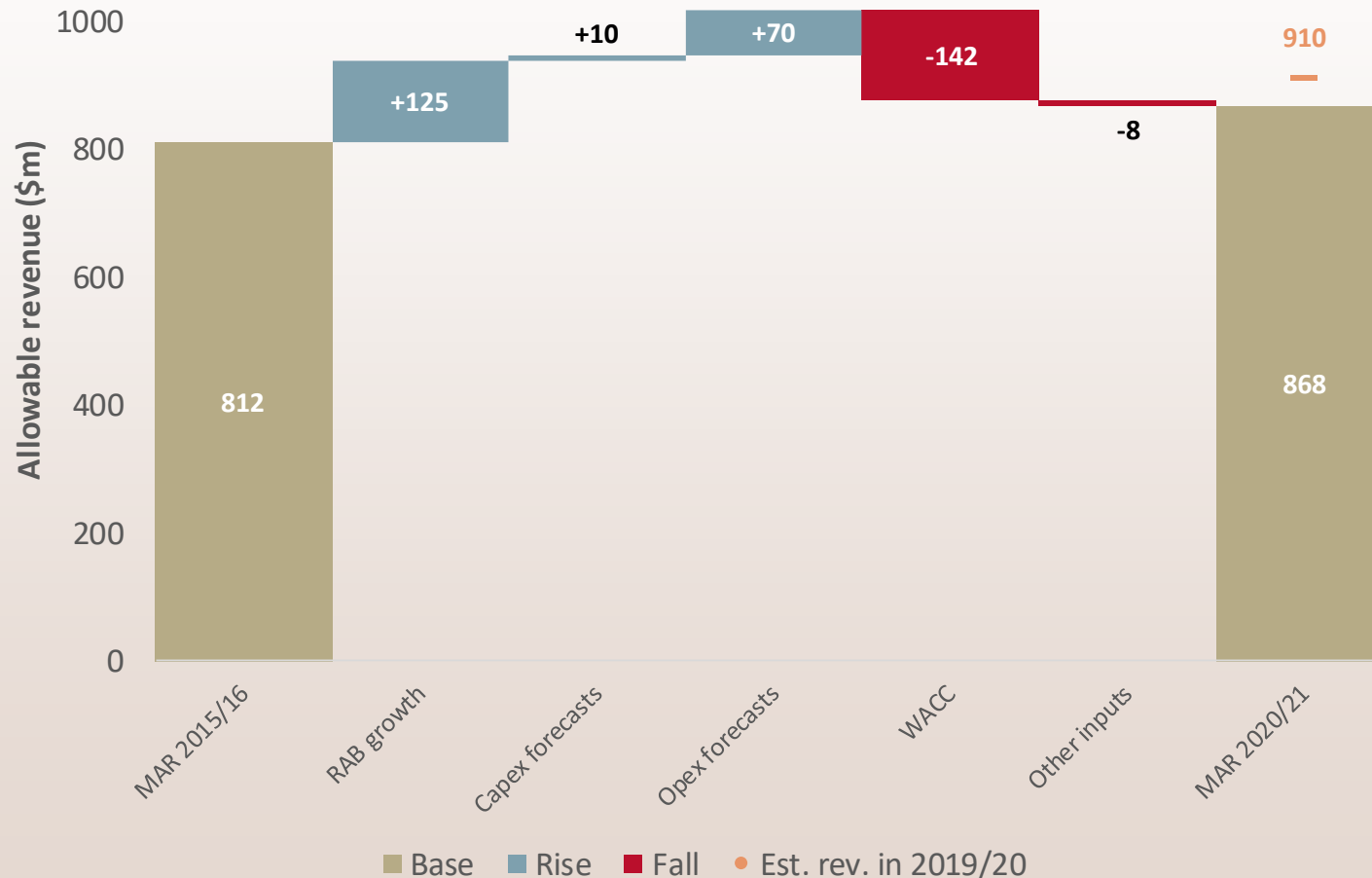
Revenue path over DPP3



- Initial 5% decrease as revenue realigned to match forecast costs
- Growth over the DPP3 period generally at CPI
- Total allowed revenue 6% higher in DDP3 v DDP2

Breakdown of revenue changes for EDBs

DPP2 starting prices v proposed for DPP3



- 2021 revenue down 4.6% on 2020
- Change driven largely by WACC
- Partially off-set by RAB and opex growth
- Revenue in 2019/20 higher than in 2015/16 because of CPI, CPRG, and X-factors

Overview of proposed DPP3 quality standards

- ‘No material deterioration’ still our starting point quality
- Retained SAIDI and SAIFI as measures of quality
- Separate standards for planned and unplanned interruptions
- Enhanced reporting following a breach of a quality standard
- Redefined major events, reset boundary values and improved major event reporting
- New measures of quality to be dealt with in ID before they can be added to the DPP



Unplanned interruptions

- Unplanned reliability standards for SAIDI and SAIIFI, based on a 10-year historical reference period (change capped at +/-5%)
- Assessed annually (removing the 2 out of 3 year rule)
- Setting unplanned reliability standard at 1.5 standard deviations above historic average
- New 'extreme event' SAIDI standard at three-times major event value (excludes weather and third-party events)



Normalising unplanned interruptions

- Changes to our approach to reduce the impact of major events on measured quality performance
- Major events now defined on a 3-hour rolling basis, rather than on a calendar-day basis
- Major events SAIDI/SAIFI values replaced with a pro-rated boundary value
 - For example, a 3 hour major event ($1/8^{\text{th}}$ of a day) would be $1/8^{\text{th}}$ of the boundary value



Planned interruptions

- Separated from unplanned interruptions
- Standard spans the entire DPP3 regulatory period
- Planned standard set at 3 times the historic average
- Additional 'notified planned interruption' definition, with further de-weighting where longer and better notice is given



Quality incentive scheme

- Retained revenue linked incentive scheme for SAIDI
- Removed for SAIPI to avoid double counting
- Incentive rate based on VoLL (\$25,000/MWh) discounted to 26% for IRIS and de-weighted by a further 20% to reflect other incentives (equivalent to \$5,200/MWh)
- Rate halved for planned outages, and halved again for notified planned outages
- Incentive cap equal to the quality standard breach limit
- Incentive collar set at zero
- Revenue at risk capped at 2% of revenue



Capex forecasts

- Capex forecasts based on EDB 2018 AMP forecasts
 - To be updated for 2019 AMPs in September
- Proposed major changes from DPP2 approach include:
 - Forecasting capex at category level
 - Applied new scrutiny checks to major categories of capex
 - Capped aggregate capex at 120% of historic level
- Results in a +5.0% (real) increase in capex allowances compared to DPP2 allowances



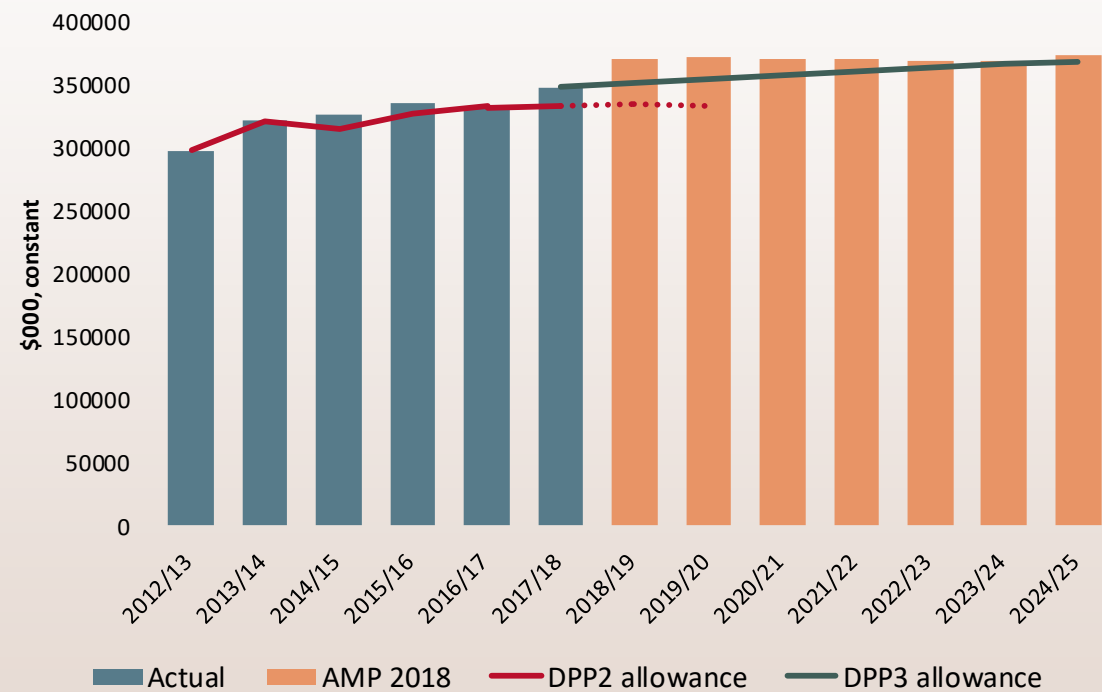
Opex forecasts

- Retained the base-step-trend approach to opex
- Two changes from DPP2 approach:
 - Opex partial productivity factor 0%
 - FENZ levies included as a recoverable cost
- Minor changes to how we calculate output scale growth rates
- Results in a +5.6% (real) increase in opex allowances compared to DPP2

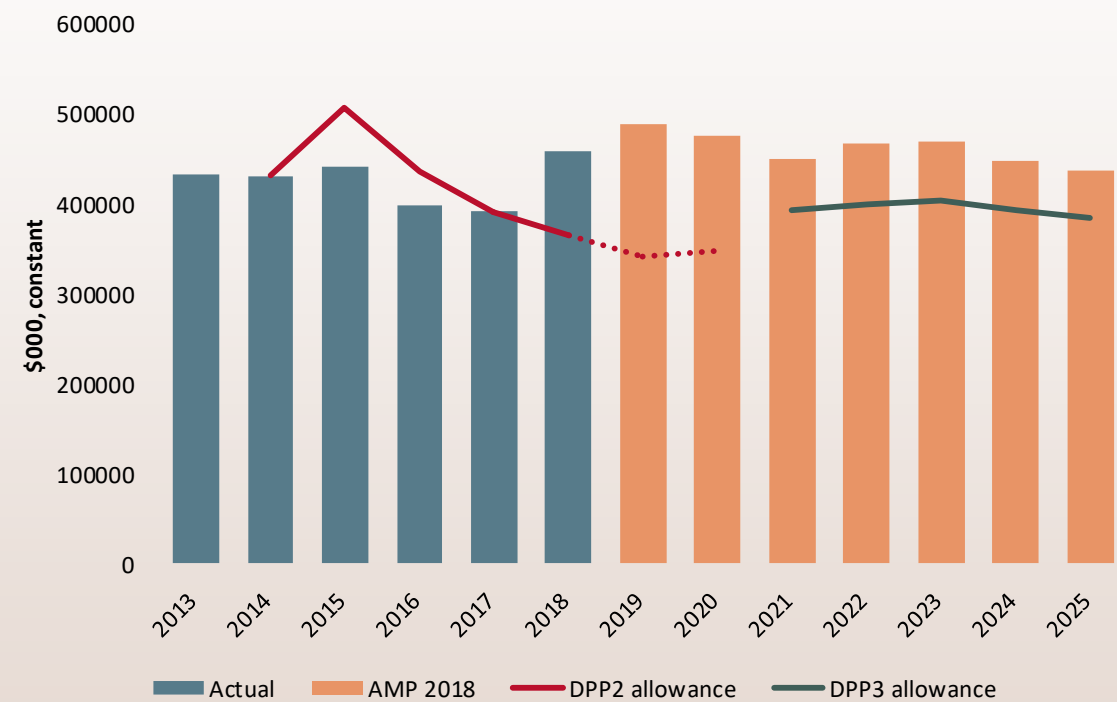


Real trends in opex and capex for EDBs

Opex



Capex



Incentives and reopeners

- Opex IRIS retention factor of 26% (determined by the IMs – effect of lower WACC)
- Capex retention factor set equal to the opex retention factor (currently 15% for DPP2)
- Introduction of new reopener for large unforeseen connections to address additional uncertainty
- Propose introducing an innovation allowance recoverable cost, capped at 0.1% of revenue (c. \$5m)



Transpower IPP draft decision



Background

- Transpower proposal submitted to us on 23 November 2018
- A Verifier was used for the first time
- We consulted on our high-level focus areas and key issues for RCP3
- We have now made draft expenditure and quality decisions for RCP3
- Transpower forecasts show significant investment needed in RCP4 and RCP5 to replace overhead wires



Overview of our draft decision (1)

- Our draft decision is to approve:
 - \$1.15b of base capex (up 1% from RCP2)
 - \$1.30b of opex (approximately the same as the RCP2 allowance).
- Draft grid output measures and asset health measures are largely the same as Transpower's proposed measures
- We propose new reporting requirements for asset management, a mid-RCP3 expert review of asset management and customer consultation processes



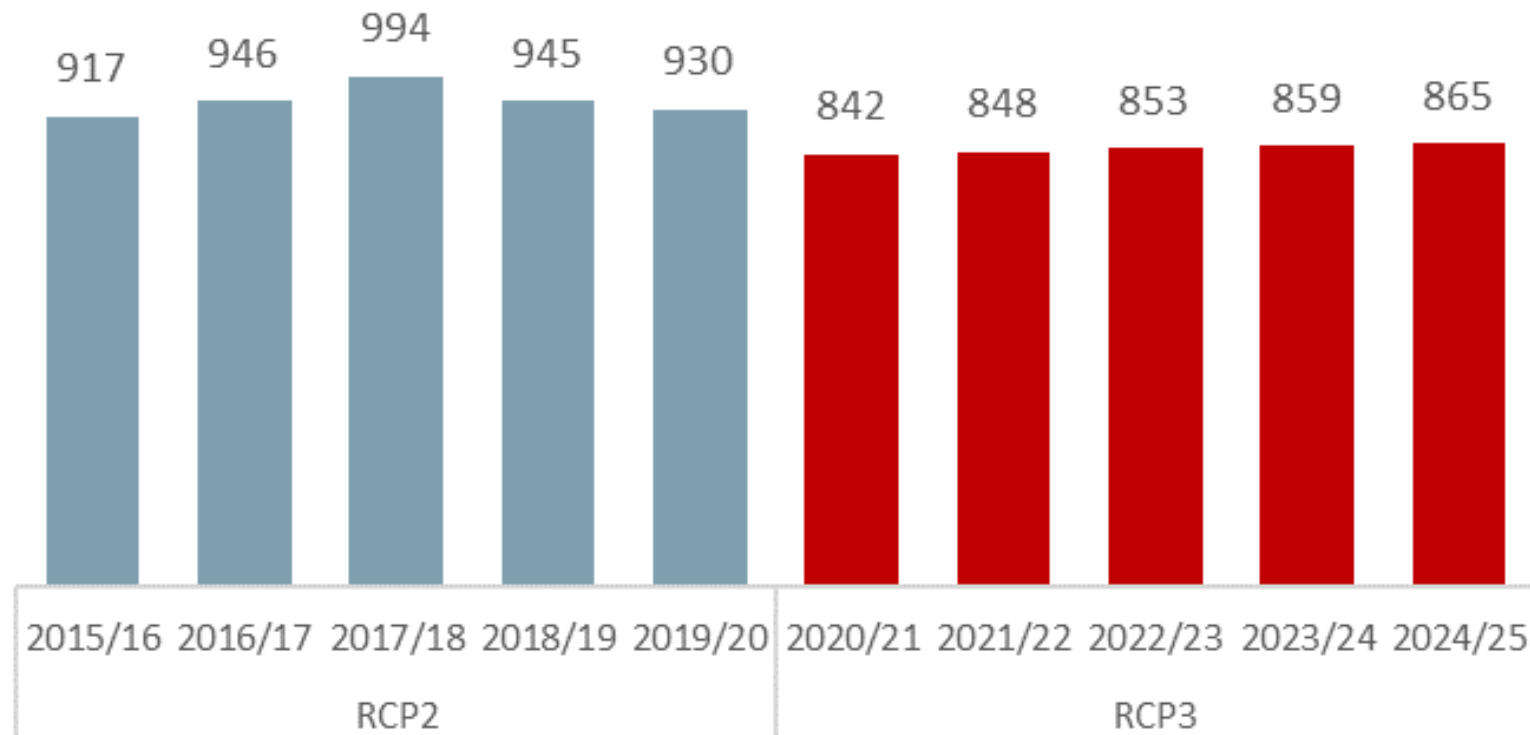
Overview of our draft decision (2)

- Allowed forecast revenue for the next 5 years will fall compared with the current 5 year period \$4.73b to \$4.27b
- Forecast annual revenues smoothed to reduce pricing volatility
- Initial fall in transmission revenues of about 9%
- Expect quality of services to be about the same as the last five years



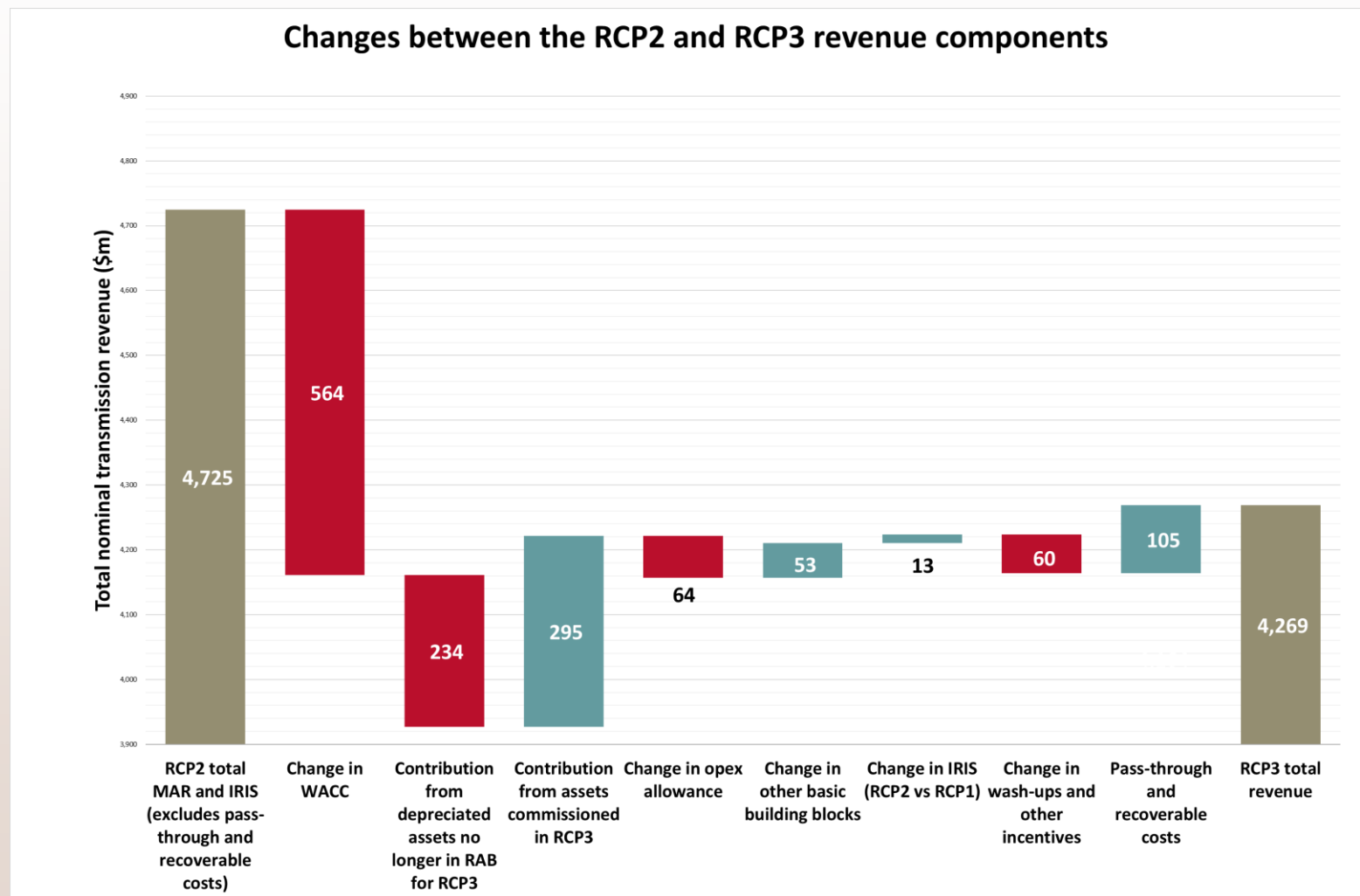
Overview of our draft decision (3)

Transpower revenue over RCP2 and RCP3
(\$m nominal)



Breakdown of revenue changes for Transpower

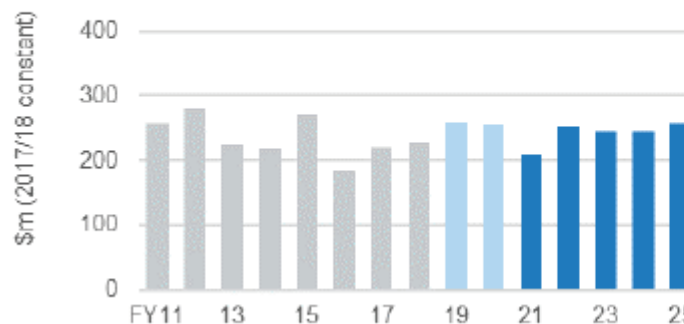
Current period v proposed for RCP3



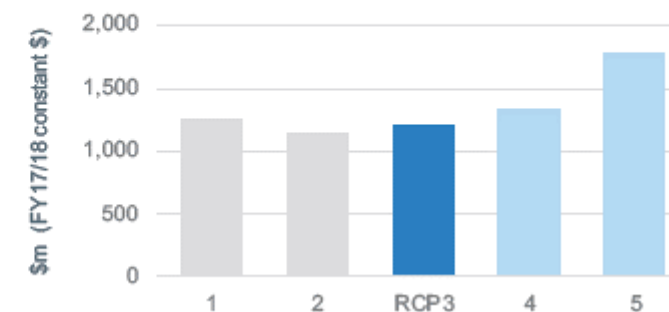
Transpower's proposal

- **\$1,202m of base capex**
(up 5% from RCP2)
- **\$1,343m of opex**
(up 2.9% from RCP2)
- 7 grid output measures
and 5 asset health
measures

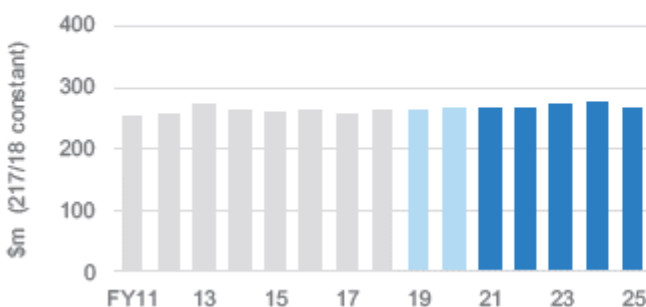
Annual overall base capex profile



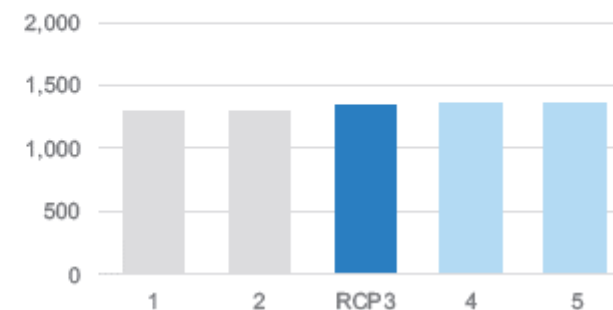
Longer-term overall base capex profile



Total annual opex profile

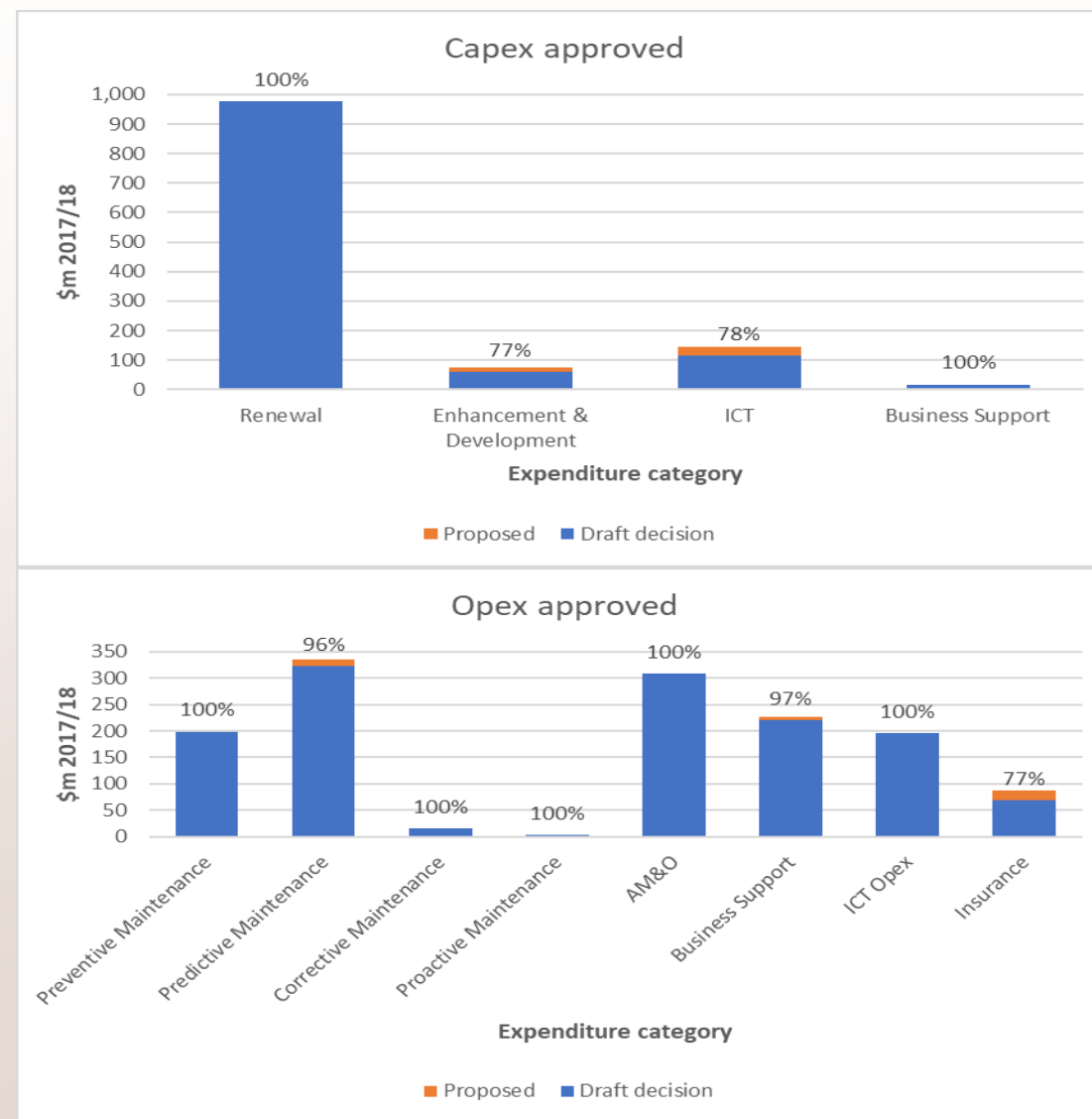


Longer-term total opex profile



Overview of changes from proposal

- Reductions for base capex in:
 - Enhancement and Development
 - ICT capex
- Reductions for opex in:
 - Predictive maintenance
 - Business support
 - Insurance



Quality measures

- Transpower proposed 7 grid output measures
- We added a quality standard on momentary interruptions (an existing measure in RCP2)
- Have revenue-linked reliability and availability measures, but not asset health measures
- We changed overall revenue-linked quantum to align with RCP2
- Draft decision is that two asset availability measures and a customer service measure will have reporting only
- Quality standards set at collar or collar + deadband with some pooling of measures



Asset management & customer consultation

- Asset health and criticality, and customer consultation were key focus areas in this reset
- Our draft decision:
 - sets further reporting requirements to measure progress in these areas
 - requires Transpower to publish RCP3 engagement plan by 1 October 2020
 - requires a mid-RCP3 expert review of asset management and customer consultation processes
- In absence of a risk model, we also propose some quality standards for minimum asset health – a proxy for risk



Process from here – next steps

EDB DPP3	Date
Draft decision	29 May 2019
Submissions due	18 Jul 2019
Cross submissions due	8 Aug 2019
Updated draft DPP	19 Sept 2019
Final DPP decision	28 Nov 2019
Determinations apply	From 1 Apr 2020

Transpower IPP for RCP3	Date
Draft reasons paper	29 May 2019
Draft determination	14 Jun 2019
Submissions due	27 Jun 2019
Cross submissions due	11 Jul 2019
Final decision and Revised draft IPP determination	29 Aug 2019
Final IPP determination	14 Nov 2019
Determinations apply	From 1 Apr 2020

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