Cross Submission to the Commerce Commission

on the

Commerce Commission's Draft Decision: Aurora Energy's CPP Proposal

18 January 2021

Contents

Introduction

1. Electra Limited (Electra) welcomes the opportunity to submit this cross submission on the *Aurora Energy's CPP Proposal, Submission on the Commerce Commission's Draft Decision, 18 December 2020* (the Aurora Submission). Nothing in this cross submission is confidential.
2. Electra owns and operates the electricity lines and assets in the Kapiti and Horowhenua districts. We are locally owned through the Electra Trust and have 45,300 beneficiaries that are the consumers connected to our network.
3. We are an exempt electricity distribution business (EDB) under s54D of the Commerce Act 1986 (the Act) and, as such, are not subject to the Default Price-quality Path (DPP) under Part 4. Despite our exempt status, we have been observing the DPP precepts. We have been closely following the DPP resets and the setting of Customised Price-quality Paths (CPPs) for Orion, PowerCo, Wellington Electricity Lines, and most recently Aurora Energy.
4. In this cross submission, we offer our support to Aurora Energy and the views it expressed in the Aurora Submission by voicing our specific concerns about the—
   i) inappropriate use of benchmarking to set allowances
   ii) setting aside of the independent verifier's report
   iii) 10% cap on total revenue unfairly shifts risk to Aurora Energy
   iv) failure of the Draft Decision to support EDBs transitioning to ISO 55000
   v) reduction in SONS
   vi) vegetation management is an industry-wide problem
   vii) quality standards are unsupported by expenditure allowances.
5. We discuss each of our concerns and offer a recommended course of action in the following sections.

Inappropriate use of benchmarking to set allowances

6. We are concerned that the Commission appears to have inappropriately used benchmarking to set Aurora Energy's allowances in the Draft Decision[1]. Further, we are concerned that benchmarking will become the expected norm by which EDBs set their expenditure forecasts.
7. We support Aurora Energy in its view that—

   > 'Benchmarking should not be used to set allowances but rather used to determine areas for potential further investigation.'[2]

8. Our preference is to use a bottom-up approach to set our expenditure forecasts. We do this to ensure that our expenditure is prudent and efficient, transparent, and is defendable to our stakeholders.

---

1 Commerce Commission, Aurora Energy's proposal to customise its price and quality standards, Draft Decision, 12 November 2020 (the Draft Decision).

2 Aurora Energy's CPP Proposal, Submission on the Commerce Commission's Draft Decision, 18 December 2020 (the Aurora Submission), paragraph 35, at page 10.

9. We accept that bottom-up approaches are more time consuming and costly than top-down approaches such as benchmarking. However, we believe that the additional expense is justified where decisions materially impact our operations and the sustainability of our network. If benchmarking is seen to be the Commission's accepted approach, it will be difficult for us to justify the expense of applying bottom-up approaches to our stakeholders.

10. We question how the Commission can gain comfort from other EDBs' expenditure requirements to be a good indicator of our own. We agree with Aurora Energy's statement—

> 'Strata's analysis focuses on a benchmarking exercise, comparing Aurora's proposed expenditure to other EDBs operating at different levels of maturity and with differing business operating models. This focus is completely at odds with the CPP process, which is intended to be a bespoke and tailored price path to reflect an EDB's unique circumstances.'[3]

11. We do not believe that setting expenditure forecasts should be based on comparing with other ELBs. Expenditure decisions are a function of life cycle asset management. Each EDB will be at a different stage of its life cycle, and as such, expenditures will necessarily also be materially different. The difference necessitates using a bottom-up approach to set expenditures rather than a top-down approach.

12. We agree with Aurora Energy's statement—

> '...benchmarking is used appropriately to identify areas for further analysis and not to calculate a reduction factor.'[4]

13. Accordingly, we recommend that for the final determination of Aurora Energy's CPP, the Commission reconsider benchmarking to set allowances.

Setting aside the independent verifier's report

14. We are concerned that the Commission appears to have set aside the independent verifier's report favouring its own contractor's views. We agree with Aurora Energy's statement—

> 'Effectively, the Commission is proposing to substitute for the detailed and evidence-based conclusions of the independent verifier a desktop-based, top-down benchmarking analysis.'[5]

15. The Commission's action puts into question the purpose of the independent verifier and the CPP process's integrity if the verifier's report can be so easily dismissed. We agree with Aurora Energy's view—

> 'This calls into question the very reason for appointing an independent verifier and means that regulated suppliers will not have any certainty as to how their expenditure is likely to be assessed.'[6]

16. While we can accept that Part 4 of the Act does not intend to give certainty of the outcome, it does intend to give certainty of process. The Commission's action to put aside the verifier's report has introduced uncertainty into a framework that has long been held in high regard because it had the certainty of process.

---

3 The Aurora Energy submission, paragraph 85, at page 20.
4 The Aurora Energy submission, paragraph 165, at page 36.
5 The Aurora Energy submission, paragraph 87, at page 20.
6 The Aurora Energy submission, paragraph 87, at page 20.

17. We support Aurora Energy's statement that—

> 'If the Commission proposes to depart from the conclusions of the independent verifier in reliance on analysis from Strata, it should assure itself that the process adopted by Strata is equivalent to that of the independent verifier in its detail, rigour, and level quality assurance.'[7]

18. EDBs have long used independent experts to provide their opinion on our methodologies, processes, and decision making. The Draft Decision puts into doubt the value of engaging independent experts when the Commission does not value independent experts' opinions, even when, in the case of CPP verifiers, the Commission is a party to that expert's appointment.

19. The Commission has not provided good grounds on which it should depart from the independent verifier's report. The lack of reasoning for departing from a fundamental process within the CPP exposes EDBs to the risk of having independent expert opinions dismissed summarily by stakeholders and replaced with other opinions without cause.

20. Accordingly, we recommend that for Aurora Energy's CPP's final determination, the Commission reconsider basing its final decision on the independent verifier's report rather than the Strata benchmarking.

10% cap on total revenue unfairly shifts the risk to Aurora Energy

21. We are concerned that the Commission has shifted the risk of under recovering the pass-through and recoverable costs to EDBs. In its submission, Aurora Energy expressed the view that—

> '…applying the cap to total revenue essentially puts the risk of pass-through cost variation onto the EDB'.[8]

22. As we understand, the Draft Decision proposes to manage price shocks by applying a 10% cap to annual changes on Aurora Energy's total revenue, which includes the maximum allowable revenue (MAR), recoverable and pass-through costs. In practice, this means that for non-exempt EDBs, the revenue recovered from delivery prices (i.e., distribution, pass-through, and recoverable) cannot be greater than +10% compared to the previous year.

23. EDBs have little or no control over pass-through (e.g., rates and levies) and recoverable (e.g., transmission) costs. In DPP2 (i.e., the regulatory period 1 April 2015 to 31 March 2020), the Commission removed pass-through and recoverable costs from the price path—

> 'We have chosen to put in place an approach to pass-through and recoverable costs to ensure distributors are able to fully recover the relevant amounts. This approach reflects the fact that the amounts are generally outside the control of distributors, so few if any incentives are created by exposing distributors to the risk of under-recovery.'[9]

24. However, in DPP3, the Commission has in effect reversed its DPP2 statement by setting a default limit of 10% on the annual percentage increase in forecast revenue from prices.

[7] The Aurora Energy submission, paragraphs 78 and 86, at pages 18 and 20 respectively.

[8] The Aurora Submission, paragraph 26, at page 8.

[9] The Commerce Commission, Default price-quality paths for electricity distributors from 1 April 2015 to 31 March 2020, Main policy paper, 28 November 2014, paragraph 5.1, at page 25.

25. In its Reasons Paper, the Commission stated that—

> 'Setting the limit was a judgement call. We have set a limit of 10% in nominal terms because we consider this a reasonable balance between what might be considered upper and lower bounds for our setting of this limit.'[10]

26. It could be argued that a judgement call is appropriate when setting the DPP as it is the least cost approach to set a one-size-fits-all regulatory instrument, and EDBs can apply for a CPP where the DPP results in perverse outcomes. However, to apply a default limit to a CPP whereby the one-size approach leaves the EDB unduly exposed seems counterproductive.

27. The Commission itself acknowledged the weakness in its judgement call by stating—

> 'If a distributor's pricing was at this 10% revenue limit but also reflected a reduction in quantities, then the pricing change could be higher than 10%.'[11]

28. Given the disruption that we are all experiencing due to the impacts of Covid-19, it is likely that Aurora Energy, and other EDBs, could find that the default cap of 10% leaves them earning a less than normal return due. The risk to EDBs under-recovering their recoverable costs increases due to the uncertainty around the TPM changes from 2023.

29. Applying for a CPP is a mechanism available to EDBs where the DPP results in perverse outcomes such as the under-recovery of costs. It is generally accepted that an EDB would apply for a CPP because of a step-change in its expenditure, as is Aurora Energy's case. However, an EDB might also apply for a CPP because of other changes in its circumstances, including an unforeseen change in its pass-through and recoverable costs resulting in its costs exceeding the 10% cap. In that instance, the CPP should be an avenue made available to EDBs to have a different arrangement that keeps that EDB whole.

30. If the Commission by default applies a cap to total revenue under a CPP in the same manner as under the DPP, then EDBs are left with no mechanism around which to be kept whole where there is an unforeseen change in their circumstances.

31. Accordingly, we recommend that for Aurora Energy's CPP's final determination, the Commission reconsider its draft decision to apply a 10% cap on allowable forecast revenue.

Draft Decision failure to support EDBs transitioning to ISO 55000

32. Like many EDBs, we consider ISO 55000:2014 to be the international standard and best-practice for asset management. Accordingly, we are transitioning our asset management practices and systems to align with this international standard. We are concerned by Aurora Energy's statement that—

> '[a]s the Draft Decision stands, our ISO55000, consumer engagement, and data improvement programmes will be crippled.'[12]

33. Electra believes that adoption of the ISO 55000:2014 principles and alignment of our processes will improve asset maintenance and investment decision making that will

---

10 Commerce Commission, Default price-quality paths for electricity distribution businesses from 1 April 2020—final decision, Reasons Paper, 27 November 2019, Attachment H, paragraph H53, at page 315.

11 Supra n10, paragraph H54, at page 315.

12 The Aurora Submission, paragraph 21, at page 8.

support improved reliability and safety performance. These anticipated benefits would be equally applicable to all EDBs who implement ISO 55000:2014.

34. If the Commission does not adequately fund the non-exempt EDBs ISO 55000 programmes and consumer engagement initiatives, we believe that a divide could develop between the exempt and the non-exempt EDBs, as each ELB may delay curtail implementation or follow some other standard that they can better afford.

35. Our concern is that a divergence between exempt and non-exempt EDBs makes it uncertain as to what good industry practice is making an already difficult system change riskier.

36. As an industry, we often describe ourselves as 'data rich but information poor.' Implementing and executing information layers into asset management system supports our transition to ISO 55000 that will bring significant efficiencies. A vital step in any system change is data improvement, which includes data cleansing and sanitation of relevant datasets.

37. Funding is imperative for data improvement and the successful transition to ISO 55000. Our concern with the underfunding of Aurora Energy is that it will be unable to continue its data improvement program and, therefore, its transition to ISO 55000.

38. If Aurora Energy is not funded to improve its data to meet ISO 55000. In that case, we can only assume that the Commission does not view ISO 55000 as good industry practice and that our data improvement program should take a different approach.

39. Underfunding non-exempt EDBs risks all EDBs failing to meet good industry practice. How do we exempt EDBs to justify the expenditure to meet a standard that the Commission will not support?

40. Becoming customer-facing is a difficult task for us as an industry. Since the Branford reforms in the 1990’s we have not been structured to interact directly with customers. Further, there is strong opposition from Traders to us engaging with customers have heavily curtailed our access to customer data. Many EDBs are developing systems, training, and upskilling their people to effectively engage with customers. This system change needs to be funded if, as an industry, we are to successfully transition to become customer-facing.

41. Perhaps the greatest risk is that a divergent customer experience results in disengaged customers. Disengaged customers place little or no value on the services they receive irrespective of the price or quality of that service. What is not valued will be substituted and not necessarily for an alternative that is in the long-term best interest of consumers.

42. Accordingly, we recommend that for the final determination of Aurora Energy's CPP, the Commission reconsider the funding levels by viewing the costs to transition to ISO 55000 and improved customer engagement as a necessary part of achieving good industry practice.

43. Reduction in SONS. We are concerned that the Draft Decision proposes a significant reduction in Aurora Energy's allowances for the system operations and network support (SONS) and People Cost Allowances. We support Aurora Energy in its statement—

> 'Proposed reductions in the SONS and people cost portfolios compromise Aurora's ability to execute its network investment programme and eliminate

> Aurora's capacity and capability to make asset management and business process improvements.'[13]

44. We question how an efficient steady state EDB has SONS expenditure that is 29%[14] and People Cost Allowance 31% lower than what Aurora Energy is proposing. The quantum of the difference between the theoretically efficient EDB and Aurora Energy is not credible.

45. Though we are not regulated, we regard the DPP framework when we set our expenditure forecasts. Accordingly, we would regard the efficient steady-state EDB when testing the appropriateness of our expenditure forecasts.

46. Once the determination is made, all EDBs will be held to account against an ideal that we cannot emulate without material reductions to operations. We do not consider this is in the long-term best interest of consumers.

47. Finding people skilled in design, system control, protection systems, etc., is very difficult. Border restrictions under Covid-19 have made the recruitment pool even smaller for the foreseeable future.

48. We liken the electricity industry to an apprenticeship no matter what level you operate. It takes up to 10 years for a person to become proficient in their field. Training and upskilling necessitate that we are resourced for both the trainee and the trainer. On the surface, this could look inefficient as you have two FTEs, both of which are dedicating 30% of their time to training and undertaking productive work. However, with approximately 40% of our current workforce retiring in the next 10 years, we consider an approach whereby we transfer experience and expertise of the older technicians and service delivery people to our newer people as the most effective way to ensure consistent quality of work and the safety of our network.

49. Accordingly, we recommend that for Aurora Energy's CPP's final determination, the Commission reconsider its decision to reduce SONS and People Cost Allowance.

Vegetation management is an industry-wide problem

50. We are concerned that the Draft Decision sets a basis for the efficient cost for vegetation management that does not fully account for its real costs. We agree with Aurora Energy's statement—

> 'The Draft Decision proposes a circa 25% reduction in the vegetation unit rate, implying that the vegetation programme can be delivered more efficiently. We disagree with this conclusion on the basis that Strata and the Commission have not justified the apparent inefficiency.'[15]

51. Vegetation management is an ongoing problem without a satisfactory solution in sight. MBIE's investigation into the effectiveness of the Electricity (Hazards from Trees) Regulations 2003 has been underway for some years. The industry has identified material cost savings are available. As yet no changes have actually been implemented.

52. We question if the conclusion of efficiency includes the all-inclusive services that EDBs provide for vegetation management or just cutting the tree?

---

[13] The Aurora Submission, Box 4: Proposed opex allowances, at page 27.

[14] The Aurora Submission, paragraph 31, at page 9.

[15] The Aurora Submission, paragraph 44, at page 11.

53. Like many EDBs, we have made step changes to our vegetation management programme to mitigate outages instances due to vegetation. Over that time, we have come to learn first-hand that vegetation programmes are more than simply cutting a tree. The programmes are about community engagement, conflict management, and ongoing education.

54. Our concern is that the Commission will set a basis for the efficient cost for vegetation management that does not take into account the real costs. Engagement is inherently inefficient as it requires people interactions, and in the case of vegetation management, interacting on a highly emotive issue, at times. Effective engagement takes trust, and trust takes time and consistent effort to build. This necessitates that we engage repeatedly with the community on vegetation management. Repeating engagement may not be efficient, but it is effective.

55. What is efficient is not necessarily effective. If we as an industry are to provide effective vegetation management, we need to fund the full service, not just the service's efficient aspects. Long term effectiveness requires community goodwill. This short-term approach will lead to community resentment, which will increase long-term costs and risks.

56. Accordingly, we recommend that as part of the final determination of Aurora Energy's CPP, the Commission reconsider the vegetation management allowance.

Quality standards are unsupported by expenditure allowances

57. We are concerned that the quality standard for unplanned interruptions is unsupported by the expenditure allowances, and as such, Aurora Energy has been set up to fail. We agree with Aurora Energy's statement—

> 'We consider that the Commission has lowered the unplanned reliability limits to levels that create an unnecessarily high risk of future breaches…'[16]

58. The quality standards measure EDB performance and deter the intentional underspending on the network to prop up profits. It appears that the Commission has set a stretch target for Aurora Energy by setting the unplanned reliability targets lower than it proposed in the CPP.

59. We are of the view that stretch targets have their place and can promote improved performance. However, how can stretch targets be appropriate where the EDB is underfunded to realise that performance?

60. Though we are an exempt EDB, we apply the quality path principles when setting our quality standards. We set our quality standards based on a mix of forecast outages to conduct planned maintenance and historical performance for unplanned outages.

61. We analyse our outages to establish trends and then target improvements. For example, we use analytics on worst-performing feeders to target maintenance and asset replacements to reduce outages' reoccurrence.

62. Over time our unplanned reliability targets change to reflect the improved performance due to our asset management practices. We accept a lag between when the analysis on outages is performed, the asset management plan is devised, the work program is carried out, and the reliability improves.

63. The time lag means that the correlation between funding and performance improvement is difficult to evidence. Therefore, linking funding to performance without

[16] The Aurora Energy Submission, paragraph 298, at page 62.

acknowledging the lag between expenditure and improved performance sends a misleading message to our stakeholders that expenditure and performance improvements should be more highly correlated than what they are in practice.

64. We fail to see how increasing Aurora Energy's risk of a breach of the quality standards is in consumers' long-term best interest. The stretch targets are likely to result in Aurora Energy breaching such standards, potentially multiple times, over the CPP period.

65. As we understand it, the process when an EDB breaches the quality standards is for the Commission to investigate the breach and, if it deems appropriate, set penalties. The investigation process is intrusive and resource-intensive for both the EDB under investigation and the Commission.

66. In the case of Aurora Energy, breaches would divert both human and capital resources to the investigation rather than delivering its CPP. This seems counter intuitive as diverting resources makes it even more likely that Aurora Energy will fail to deliver its works program, thereby underperforming its quality standards and potentially penalised for a breach.

67. Accordingly, we recommend that for the final determination of Aurora Energy's CPP, the Commission reconsider the setting of the unplanned reliability targets to a level that better reflects the expenditure allowances and supports Aurora Energy successfully delivering its CPP.

Closing comments

68. In summary, we recommend that for the final determination of Aurora Energy's CPP, the Commission reconsider—

    i) the use of benchmarking to set allowances

    ii) basing its final decision on the independent verifier's report rather than the Strata benchmarking

    iii) it's draft decision to apply a 10% cap on forecast allowable revenue

    iv) the funding levels to be applied by considering the costs to transition to ISO 55000 as part of good industry practice.

    v) its decision to reduce SONS

    vi) the allowance for vegetation management

    vii) the setting of the unplanned reliability targets to a level that better reflects the expenditure allowances and supports Aurora Energy successfully delivering its CPP.

69. The primary contact for this cross submission is—

Dylan Andrews
General Manager — Lines Business
dylan.andrews@electra.co.nz
027 443 2227