

Cross-submission by Pat Duignan re Commission Draft Decision on Powerco CPP Proposal

1. I am making this personal cross-submission regarding the draft decision on Powerco's CPP proposal to customise its price and quality standards because the issues involved are significant matters of principle.¹ I contributed to the expert report by TDB Advisory to the Electricity Retailers Association of New Zealand on the Commission's Issues paper regarding the Powerco proposal, but this submission is not commissioned by ERANZ or any other party.
2. As emphasised in my submission, the Commission's decision on Powerco's CPP proposal is exceptionally important because it will set a precedent as the first CPP proposal justifying a higher revenue cap as necessary to stabilise the reliability of the network.
3. Powerco's CPP application stated *"Our customers advise us they do not expect improved reliability where this comes at a cost (other than in poor performing pockets of the network). However, they would not accept deteriorating performance."*² The independent Verifier confirms *"Customers have clearly said that they do not want to pay for improved reliability"*³.
4. The application asserted that *"Our proposed CPP investments reflect [customers' preference], by seeking to arrest deteriorating asset performance and stabilise SAIDI and SAIFI at present levels."*⁴
5. The Verifier, however, concluded that the frequency and duration of outages (SAIFI and SAIDI) would be reduced by the proposed increase in expenditure (of over 40% compared to the previous 5 years). The Commission agreed with the Verifier's assessment and the draft decision required SAIFI and SAIDI reductions of 5% and 10% respectively over the CPP period. Furthermore, Powerco's own submission argues that observable network improvements will be lagged. That implies the increase in expenditure would result in additional improvements in reliability beyond the CPP period.
6. Powerco now accepts, in its submission, that the 40% increase in expenditure in the draft decision should be compatible with a reduction in SAIDI and SAIFI. The submission proposes the targets for SAIDI and SAIFI reductions by the end of the CPP period be only half those proposed by the Commission reflecting in part a two-year lag before expenditure increases result in reliability improvements.⁵ I applaud Powerco's candour in changing its description of the reliability outcome.
7. Thus Powerco, as well as the Commission, now acknowledge that the expenditure allowed in the draft decision involves customers paying for improved reliability, contrary to customers' preferences as assessed by the Verifier.
8. The draft decision indicates that the Commission believes it is unable to reduce expenditure to a level that would reflect customers' preference not to pay for improved reliability, because it is too difficult to determine what lower level of expenditure is required to maintain safety standards as opposed to reliability. Powerco's submission's acceptance that the expenditure

¹ As a matter of disclosure, I record I was a member of the Commission from mid-2009 to December 2015.

² Powerco *"Customised Price-Quality Path – Main Proposal"* (12 June 2017), page 208.

³ Verifier's report, *"Powerco's Customised Price Path Application"*, (12 June 2017), section 2.2.5 page 29

⁴ Powerco *"Customised Price-Quality Path – Main Proposal"* (12 June 2017), page 208.

⁵ Powerco also propose that the required SAIFI and SAIDI reductions affect revenue but not legal compliance.

level in the draft decision involves customers paying for improved reliability, means it is entirely reasonable for the Commission to ask Powerco to assess what reduction in expenditure would be compatible with its customers' preferences not to pay for reliability improvements while maintaining safety standards.⁶

9. Aurora's submission is highly relevant in this situation. Aurora explain "*the iterative process has meant that Powerco has been able to provide the Commission with additional and new information that the Verifier did not have available when it was compiling its report. The lesson we take from this, is that it important that the CPP applicant has multiple opportunities to respond to questions about aspects of its proposal, and is able to provide additional evidence and information in justification.*"
10. I agree with Aurora that Powerco having the opportunity to respond to Commission enquiries is essential to the CPP determination process. That of course cuts both ways. The Commission is entitled to ask questions. Now that the applicant, the Verifier and the Commission are all agreed that the level of expenditure in the draft decision involves customers paying for improved reliability, the Commission can ask Powerco how the level can be adjusted to conform to customers' preferences.
11. I therefore cross-submit that the Commission's response to Powerco's submission's new view regarding reliability improvements together with Aurora's submission regarding dialogue and adjustments during the CPP process will create a precedent for future CPP determinations. Aurora clearly considers the dialogue to date has been to Powerco's advantage. The issue now at stake is whether the Commission will continue that dialogue to obtain answers that would enable modification of the draft decision to better reflect customers preferences. The draft decision makes no reference to any discussion between the Commission and Powerco regarding the reliability outcomes of the expenditure level or modification of the expenditure level to reflect customers preferences regarding reliability. This may reflect Powerco not knowing the Commission's view until the draft decision was published.
12. Powerco's submission responds to the Commission's draft decision by arguing that the reliability improvement would lag the expenditure and also arguing against improvements being legally required as opposed to the outcome affecting Powerco's revenue. The submission does not mention the option of a reducing the expenditure level to be consistent with an unchanged reliability outcome. Having received the submission, the logical response is for the Commission to ask Powerco about that option.
13. Aurora's assessment that the dialogue between Powerco and the Commission has been fruitful can be taken as a tribute to the quality of Powerco's responses to Commission questions. This is a good basis for the Commission to now ask the question of how the expenditure level can be modified in the expectation that Powerco will provide quality responses to that question. It would be disappointing if the Commission dialogue with Powerco on this issue was less fruitful.
14. The legal framework for customising a price quality path is relevant here since it provides that any appeal would be on a closed record basis. The current situation is that in the draft decision the Commission indicated it believed it did not have sufficient information to adjust the expenditure level to conform to customers' preferences. As described above, Powerco's submission has not provided the information that the Commission would need to adjust the

⁶ The Verifier's report in effect anticipated the need for such a dialogue with Powerco, recommending, on page 29, "*We do, however, consider that the Commission should focus on the relationship between Powerco's proposed expenditure forecasts and the impact on reliability when undertaking its own assessment of the information.*"

expenditure level. If the Commission does not ask the question of Powerco then that would in practice compromise the effectiveness of the Part 4 provision for customer representatives to obtain a merits review of the CPP decision, if they so wish.

15. In section 3 of its submission, Aurora lists some aspects in which the Powerco CPP will set precedents. The first aspect is providing confidence that 'reasonable investor expectations' will be satisfied which the submission suggests directly flows into incentives to invest and ensuring regulated suppliers provide services at a quality that reflects consumer demands.
16. Powerco's submission demonstrates an enthusiasm to undertake capital expenditure as illustrated by the fact that Powerco is seeking to undertake expenditure, specifically capital expenditure that, on its own admission, is greater than is needed to maintain reliability. As discussed in my submission, this indicates that the Commission's WACC IM has achieved the objective of incentivising investment.
17. Aurora's submission notes the main component of the TDB Advisory submission on the Issues Paper was advocacy of the application of CBA to the CPP determination and service quality standards. Both the TDB Advisory submission and my submission on the draft decision explain that the Commission must determine what are "appropriate service standards" before the expenditure objective can be applied. No one has yet offered any alternative basis for this decision other than consideration of the cost versus benefit of possible service standards. (As noted in my submission, in some cases the Commission may be required to adopt standards set by other government agencies in which cases the other agencies are responsible for the cost benefit analysis.)
18. The Aurora submission suggests advocacy of the use of cost-benefit analysis would be a " 'mid-play' changing of the 'rules of the game' ". This trivialises the issue.⁷ Thoughtful investors would recognise that there is no reason to see the issue as involving a conflict between investors and consumers. There is no game to be won by investors at the expense of consumers. This issue differs from other components of regulation where investor and consumer interests do diverge. Investors will be as well off if service standards are lower with investment being correspondingly lower.⁸ Such investors would recognise that the stability of the regulatory framework depends on respecting customers' preferences or, where preferences are not well informed, ensuring that any increase in quality, i.e. improvement in reliability, can be demonstrated to be beneficial to consumers.
19. I acknowledge that it is inconvenient that the need to determine what are appropriate service standards before testing whether the expenditure objective is met was not addressed explicitly in the CPP IM. (I have to accept some responsibility for that.) That is however the reality. The adoption of the historical outcome-based DPP quality standards was the solution suggested by the Verifier. The assertion that the expenditure level in the draft decision meets the expenditure test could be interpreted as implying the Commission is determining that the resulting higher

⁷ The issue of the relationship between the level of investment and reliability outcomes was highlighted in the Verifier's report which recommended, on page 20, as a "Key Issue": "*The Commission may wish to undertake its own analysis of the likely reliability benefits arising from the proposed capex and opex programs, or engage with Powerco to have its models refined.*" Thus the need for detailed analysis - which would provide some of the information that the Commission lacks and facilitate a cost benefit analysis - was identified as a key issue early in the CPP process. Thus Powerco has been on notice for a long time that this information is needed.

⁸ If the WACC uplift has resulted in excess returns to investment, lower service standards and lower investment might involve foregoing some excess returns but it would be shortsighted for lines companies to over invest to game the provision of the WACC uplift. If consumers perceived that lines companies were "gold plating" that could be expected to provoke a reaction detrimental to lines companies (and to the regulator's reputation) as seems to be occurring in the UK and Australia.

reliability is the appropriate service standard. Perhaps the Commission will set out a definitive view on this issue in its final decision.

20. I submit that the inconvenience of undertaking a cost-benefit analysis is outweighed by the benefits for the lines business concerned, independent of whether such an analysis is required by the IM. Customer satisfaction is valuable even for a monopoly. When Powerco comes to put up its prices after the CPP is approved, it would be in a better position to retain the goodwill of its customers if it had available a cost-benefit analysis that demonstrated the increase in reliability was worth the cost for consumers on reasonable assumptions. Thus I submit it would be in the interests of both the Commission and Powerco for the two to work together to publish a cost-benefit analysis. I recognise that this might require a brief further consultation but the exercise could be completed expeditiously if all involved devoted appropriate resources to the task.
21. Obviously, the timeframe for a final decision on the Powerco application is tight. As a last resort, it would be reasonable for the Commission to ask Powerco to agree to an extension of the timeframe, but that could be avoided if Powerco applied sufficient resources to providing the necessary information to the Commission.
22. Aurora's submission could be read as indicating opposition to inclusion of a cost benefit analysis in the CPP application it is understood to be currently preparing. I suggest that in their own interest, CPP applicants should follow the example set by Wellington Electricity and undertake a cost-benefit analysis as a component of their proposals.
23. It is relevant that Aurora is owned, via a holding company, by Dunedin Council. Thus there is significant overlap between its customers and its ultimate owners, Dunedin citizens. That is an additional reason for Aurora's Board to want to confirm its CPP proposal is beneficial for customers by undertaking a cost-benefit analysis despite the additional work load for Aurora's management and those preparing the application.



Pat Duignan
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