



29 November 2017

Robert Bernau

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Regulation Branch

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Dear Rob

**Feedback on Commission priorities open letter 9 November 2017**

Orion New Zealand Limited (Orion) welcomes the opportunity to comment on the Commerce Commission's (the Commission) open letter "**Our priorities for the electricity distribution sector for 2017/18 and beyond**", 9 November 2017.

**Summary**

1. We support the initiative to provide more transparent and accessible performance information, subject to meaningful metrics, for the general public where this information is viewed in the context of each individual EDB's business context without comparative benchmarking to other EDBs.
2. We support the Commission's acknowledgement of EDBs role in maintaining resilience and its increased focus in this area.
3. It is important to provide clear guidance on what is considered 'good' asset management in AMPs, providing appropriate opportunity for EDBs to respond, before publically highlighting poor performance or initiating formal enforcement.
4. We welcome the opportunity to engage with the Commission in a region specific discussion on asset management, our challenges and our views of the future.
5. We believe it would be helpful to understand what the Commission's views and expectations are with respect to adequate customer consultation and engagement. The ENA Customer Engagement Working Group may be a useful forum for an industry conversation on what EDB engagement programmes should be. We will be seeking to discuss our own programmes of work in this area with you.

6. The Commission should seek to demonstrate that a CPP is a structured, clear and efficient process where good reason initiates application rather than necessarily a “cost-effective” option when compared to a DPP.
7. We do not support shortening the regulatory period from 5 years to 4 years as this will increase compliance costs and could lead EDBs into short term thinking.
8. We feel that the ‘new technology’ term has become overused and the turn of discussion risks preventing EDBs from investment and implementation in what should be a natural evolution in the operation of the core network using advanced sensing, monitoring and control for the long term benefit of consumers.
9. In respect of SAIDI/SAIFI performance measures at times ‘no material deterioration’ will need to be balanced with a di-minimis perspective given local context.

#### **Performance of EDBs**

10. The Commission has conveyed a strong desire to make better use of data and improved transparency of data for EDBs to promote good asset management practices.
11. Making disclosure and other information about EDB performance more transparent and accessible for wider audiences of stakeholders and the general public has merit and we support the initiative. However we note in paragraph 31 of the Commission’s open letter the Commission is seeking to allow easy comparison of EDBs’ data and metrics. We are not convinced there is benefits in comparisons, even in peer groups as suggested, as each EDBs’ circumstances are unique. What is critical is for customers to understand the context and drivers of each individual business. It would be a negative outcome if a drive to benchmarking over-rote a requirement to meet the (different) needs and realities of customers in each region. Benchmarking tends towards simplistic: hiding the necessary trade-offs in each location.
12. Section 53P (10) of the Commerce Act , precludes benchmarking when setting starting prices, rates of change, quality standards, or incentives to improve quality of supply. The merits or otherwise of comparative benchmarking has been the subject of historical consultation and submissions, and parliamentary consideration. Enactment of Section 53P(10) indicates that this approach was not adopted for setting starting prices, rates of change, quality standards, or incentives to improve quality of supply.
13. Further to that, it is important that performance ratios are meaningful. For instance a renewals-to-depreciation ratio appears to compare two parameters that have no practical or direct link to each other. The depreciation on a RAB set at the beginning of the price-quality path regime does not govern

or direct asset management renewal decision making. Asset management decision making is driven by such things as asset knowledge, asset condition, locational information, economic growth and other regulatory guidance such as the Health and Safety at Work Act. The feedback from customer engagement is also a pivotal factor.

14. Performance monitoring should not be limited solely to the assessment of numerical ratios in the absence of a greater understanding of the business context, environment and process of each individual EDB.
15. For this reason we appreciate the degree of importance the Commission places on AMP (for both customer and Commission purposes) and the Commission's desire to understand an EDB's specific context by visiting EDBs in their local settings.
16. EDB asset management performance, as disclosed through Schedule 13 (report on asset management maturity) of the information disclosure determination, provides evidence of the maturity of asset management best practice delivery. This evidence is within the context of a particular business setting without direct comparison to other EDBs with completely different context and environment.
17. In the Gas DPP reset process a number of ratios are used to assess GDBs performance. EDBs would welcome a greater understanding of whether there is any purpose for the parameters contained in the performance accessibility tool beyond making information more accessible to stakeholders and the general public. Would they be used in a DPP reset?
18. We submitted, in relation to Powerco's CPP consultation, that "there needs to be an open and honest debate with the public about the costs of moving to a low-carbon economy". The Commission's approach to increasing transparency of information could extend to supporting societal understanding of the broader implications of emerging technology within the context of a low-carbon economy.

#### **Effective asset management and review**

19. The Commission has conveyed an important focus on risk (probabilistic) based asset management, accounting for the risk of asset failure versus the consequences of failure to target asset remediation actions.
20. We support the Commission's acknowledgement of EDBs role in maintaining resilience and its increased focus in this area. We agree that "key issues for the sector include distributors' ability to manage their assets effectively, to maintain resilient networks, and to do both of these in a changing environment." Resilience is fundamental to EDB's delivering on their social licence to operate and to discharge their lifeline utilities role under the Civil Defence Emergency Management Act for the long term benefit of consumers.

21. Asset health and criticality, prudent reinvestment in assets and maintaining appropriate levels of network resilience are required to demonstrate best practice asset management within the performance levels desired by customers.
22. Developing industry guidelines on asset criticality or network resilience by using industry expertise via ENA and EEA is a pragmatic approach to ongoing improvement and maturity in these areas. Industry could also look to publish case studies demonstrating good asset management practice and outcomes that have benefited customer experience of performance or will improve resilience in the event of a low probability, high consequence event (i.e. the Alpine Fault).
23. Evolving and demonstrating application of risk management approaches must be underpinned by good asset data, data analysis and judgement. This requires investment in back office systems that support consistent process and improve efficiency in this judgement and decision making as information, trade-offs and potential outcomes become more complex.
24. In paragraph 48 of the Commission's open letter, the Commission indicates that it is prepared to use the full range of enforcement available and as appropriate. In paragraph 18 the Commission mentions its intent to issue a brief report, early next year, highlighting some examples of good asset management practices in AMPs. It is important to provide clear guidance on what is considered 'good' asset management in AMPs, providing appropriate opportunity for EDBs to respond, before publically highlighting poor performance or initiating formal enforcement.
25. We look forward to the Commission's review of AMPs and report highlighting examples of good asset management practices. We agree that the AMP should be a core document in any regulatory assessment of forecast expenditures.
26. We seek clarification on the Commission's paragraph 20 where you suggest visits will include engagement with owners. When referring to 'owners' does the Commission mean customers/stakeholders of trust owned businesses or commercial shareholders of businesses?
27. We welcome the opportunity to meet the Commission in our region and discuss our particular regional and business challenges, opportunities, successes and learnings.
28. Taking this 'deep slice' approach will facilitate a shared understanding of the asset management landscape, including changing consumer preferences in particular regions.

### Consumer views and preferences

29. The Commission has reiterated their focus on customer consultation and engagement, particularly around concerns related to changing technology, and the desire to pay for reliability and security. We believe it would be helpful to understand what the Commission's views and expectations are with respect to adequate consultation.
30. We are undertaking a comprehensive engagement programme with customer workshops, willingness to pay surveys, and are looking to form an advisory panel. We would be happy to discuss what we are doing with you.
31. The price-quality trade off proposition can be a complex topic to convey to the public. An element of education including context is required to help set the scene.
32. There can be benefit in enlisting a consistent group of representatives to engage with over time to prevent the requirement for continual reset of context.
33. The ENA Customer Engagement Working Group may be a useful forum for an industry conversation on what EDB engagement programmes should be.

### CPP v DPP

34. The Commission has signalled their desire to demonstrate that a CPP is a "cost-effective" option.
35. Our understanding and experience is that a CPP is a higher scrutiny path than a DPP which by default results in a more costly process to application and outcome for a CPP than a DPP.
36. In assessing a CPP, additional evaluation criteria apply and in particular consideration of whether the EDB's proposed expenditure reflects the efficient costs that a prudent supplier of electricity lines services would require to meet or manage expected demand for its services, at appropriate service standards<sup>1</sup>. This is the **expenditure objective**. Meeting the expenditure objective was expressed in a number of ways during our own CPP application process and included:
  - "Whether policies, strategies and procedures are appropriate, such that services will be provided efficiently and align with consumer demands. We have also considered whether Orion's policies, strategies and procedures have been applied in practice."<sup>2</sup>

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<sup>1</sup> Electricity Distribution Services Input Methodologies Determination 2012 [2012] NZCC 26, clause 1.1.4

<sup>2</sup> Setting the customised price path for Orion New Zealand Limited, 29 Nov 2013, clause 2.23 page 26

- “The expenditure objective is designed to reflect efficient investment (i.e., investment that occurs at the appropriate time and results in services being provided at an appropriate quality)”<sup>3</sup>.

Whether a CPP applicant has met the expenditure objective requires scrutiny and judgement by the Commerce Commission and its independent experts.

37. A DPP is substantially determined based on regulatory information disclosures already in place – past opex/capex actuals and AMP forecasts and qualitative content. Industry understanding is that this is a low-cost approach.
38. The Commission should seek to demonstrate that a CPP is a structured, clear and efficient process where good reason initiates application rather than necessarily a “cost-effective” option compared to a DPP.

#### **DPP Reset- Process**

39. The Commission has posed a number of questions, in its attachment, around the 2020 reset.
40. A move to a revenue cap will be new for all EDBs. We encourage the Commission to work with the industry to promote understanding of this new regime.
41. We observed the process undertaken for the gas reset and have considered elements of this approach in preparation for our next AMP. Given our particular circumstances, coming off a CPP to a ‘gap year’ and then onto a DPP, we believe taking account of a supplier’s specific circumstances is appropriate and necessary in setting our DPP.
42. In paragraph 8.2 of the Commission letter you say you may follow a similar approach to that followed for the 2017 gas reset with EDBs.
43. EDBs will begin preparing AMPs to be published at 1 April 2019 early next year. We encourage early Commission consultation on any new process for reset assessment, given the importance the Commission may place on AMPs, to allow EDBs to reflect requirements into AMPs. Internal approval process can see draft AMPs being presented to board by December 2018, and therefore any change in process/requirements may leave little time for EDBs to react in relation to AMP content.

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<sup>3</sup> Setting the customised price path for Orion New Zealand Limited, 29 Nov 2013, clause 1.33 page 16

### **DPP Reset- Regulatory Period**

44. While we agree that there is both science and art in determining longer term forecasts, we do not support shortening the regulatory period from 5 years to 4 years.
45. This approach will increase compliance costs (a 25% increase in cost if we move to 5 rather than 4 resets in 20 years) for both EDBs and by extension consumers. Shortening the regulatory period has the potential to lead EDBs into short term thinking which we believe is at odds with the long-term thinking required for infrastructure businesses. A change may also affect debt facilities management and costs. Nor do we think a shorter period will address forecasting difficulties.

### **DPP Reset- Technology**

46. It now seems timely and prudent for industry and regulators to consider alignment of incentives to spend opex versus capex.
47. Emerging technology options for consumers 'behind the meter' has created much discussion across the electricity supply chain about the future of transmission and distribution, and the line between regulated and unregulated services.
48. Discussion about new technology refers to adoption and choices made by customers (on the demand side) affecting how the distribution sector will look and operate. We submit that the 'new technology' term has become overused and the turn of discussion risks preventing EDBs from investment and implementation in what should be a natural evolution in the operation of the network using advanced sensing, monitoring and control for the long term benefit of consumers.
49. There appears to be a risk that efficiency improvements are discarded where they are categorised as network evolution (refer Powerco draft decision<sup>4</sup>).
50. EDBs have historically evolved their systems to improve customer service including use of more sophisticated control systems. The World Economic Forum, in its March 2017 paper entitled 'The future of Electricity- New Technologies Transforming the Grid Edge', summarised the electricity transformation as a grid edge transformation driven by three factors; electrification, decentralisation and digitisation.

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<sup>4</sup> Attachment D, Powerco's proposal to customise its prices and quality standards- Commission Draft decision, 16 November 2017

51. The industry's supply chain focus on traditional 'poles and wires' overlooks the important requirement for further digitisation by EDBs to deliver enhance automation and control of field devices with the outcome being more efficient service delivery in line with changing expectations of customers.
52. It also has the potential to limit innovation by EDBs by preventing their use of evolving storage options (on the supply side) in preparing their systems to respond resiliently and reliably to the various events that impact supply side service.
53. For the foreseeable future a 'two-way' system must rely on the safe, resilient, reliable and secure delivery of electricity to and from customers via distribution infrastructure.
54. It is not only for EDBs to shift their thinking with respect to traditional 'poles and wires' but also for regulators and the electricity supply chain. Other industry roles such as distribution system operator, aggregator and others we have not identified as yet will develop over time.

#### **DPP Reset- Reliability**

55. We endorse the Commission engaging with industry on reliability incentives and building knowledge of the learnings and challenges for EDBs in delivering reliability on a SAIDI/SAIFI performance measure.
56. Working to achieve SAIDI/SAIFI limits can be challenging given the many variables influencing this performance measure.
57. Weather remains the biggest contributing factor to results and its variable nature can significantly impact results year on year. For instance we experienced a benign weather year in 2017 which was reflected in the Commission's 2017 performance summary result with a minus 44% 3 year CAGR for SAIDI and a minus 16.4% 3 year CAGR for SAIFI.
58. Major event days caused by weather are increasing over time and this is supported by NIWA data<sup>5</sup>. Our analysis suggests that on average over the last five years we experienced major event days 3 times per annum. This is above the Commissions 2.3 event days per year on a national basis. Therefore many weather events do not meet the capped event criteria.
59. Performance results are influenced by third party contact with our infrastructure. We work hard to educate the community about these risks and the impact on customers.

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<sup>5</sup> *Scenarios of Storminess and Regional Wind Extremes under Climate Change*, <https://www.niwa.co.nz/our-science/climate/information-and-resources/clivar/scenarios>



60. Historical trending is not always predictive of future trending especially where, for instance, a community goes through a sustained period of growth. This type of environment can increase third party contact events which will naturally tail off as construction and infrastructure activity settles back to more 'normal' levels.
61. The principle of 'no material deterioration' in reliability must be governed by the changing characteristics of an EDB's local economy and customer preferences. At times 'no material deterioration' will need to be balanced with a di-minimis perspective given local context. It may not be appropriate to expect continuing downward pressure on SAIDI/SAIFI especially if customer engagement indicates satisfaction with current performance levels.
62. We encourage the Commission to take a forward looking view for performance measures using individual EDB SAIDI and SAIFI forecasts, supported by evidence, to guide SAIDI/SAIFI limit setting. EDBs can quantify the expected improvements from reliability focussed expenditure programmes in SAIDI/SAIFI forecasting.

**Concluding remarks**

Thank you for the opportunity to provide this feedback. We do not consider that any part of this feedback is confidential. If you have any questions please contact Dayle Parris (Regulatory Manager), DDI 03 363 9874, email [dayle.parris@oriongroup.co.nz](mailto:dayle.parris@oriongroup.co.nz).

Yours sincerely



Dayle Parris

**Regulatory Manager**