Cross-submission

Commerce Commission: Default price-quality paths for electricity distribution businesses from 1 April 2020 - Issues Paper

31 January 2019

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1 Introduction

1.1 Aurora Energy welcomes the opportunity to cross-submit on the Commerce Commission's (Commission) *"Default price-quality paths for electricity distribution businesses from 1 April 2020 – Issues Paper"* (Issues Paper).

1.2 No part of our cross-submission is confidential and we are happy for it to be publicly released.

1.3 If the Commission has any queries regarding this cross-submission, please do not hesitate to contact:

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2 General comments

2.1 Having had the opportunity to review the submissions received by the Commission on the Issues Paper, the views we expressed in our submission on 21 December 2018 (Submission) remain largely unchanged.

2.2 While we generally support a number of views expressed by other submitters, there are some views with which we do not agree, and which we discuss in this cross-submission.

2.3 We note the Commission's comments in the Issues Paper which refer specifically to Aurora Energy's intention to apply for a customised price-quality path but that *"Nevertheless, as Aurora will be on the DPP for at least one year, we will need to set workable starting prices and quality standards."*[1] We have been working with the Commission for the past 18 months in relation to our performance under the current DPP and, while the Commission has stated in the Issues Paper that it has not yet formed a fixed view of what those workable starting prices and quality standards would entail[2], it is important that we have clarity early on in the reset as to the approach that it intends to take.

2.4 We find it disappointing to see some submitters raising issues that fall outside of the scope of the Issues Paper consultation. In particular, Genesis raises matters relating to amalgamation and standardisation within the electricity distribution sector[3] for which there are more appropriate forums for such comments, and indeed have already been made more appropriately in its submission to the Electricity Price Review panel[4]. Mercury has also taken the opportunity to express its view on a review of the regime[5], which again is, in our view, inappropriate for the consultation at hand.

2.5 Certain comments made by submitters link, in our view, to the larger issue of asset management maturity that electricity distribution businesses (EDBs) are currently faced with.

2.6 Fonterra has stated that it supports the qualitative analysis of asset management plans by accredited auditors to ISO 55000 "Asset Management"[6]. We agree that there is a need to lift asset management maturity and, to that end, we have committed to achieving ISO 55000 certification by 2023[7]. We are conscious, however, that a step change in broad asset management compliance requirements, such as that proposed by Fonterra, will likely result in

[1] Commerce Commission. (2018). *Default price-quality paths for electricity distribution businesses from 1 April 2020 Issues Paper*. 15 November 2018; para 5.36.
[2] Ibid at 1; para 5.37.
[3] Genesis Energy. (2018). *Default price-quality paths for electricity distribution businesses from 1 December 2020*. 20 December 2018.
[4] Genesis Energy. (2018). *Genesis Energy's submission on the electricity price review first report*. 23 October 2018; para 1.4.
[5] Mercury. (2018). *Default Price-Quality Paths for Electricity Distribution Businesses from 1 April 2020*. 20 December 2018; pg 1.
[6] Fonterra. (2018). *Re: Consultation Paper "EDB DPP3 Issues Paper"*. 20 December 2018; pg 2.
[7] Aurora Energy. (2018). *Asset Management Plan 2018*. Para 7.1.1.

instances of immediate non-compliance. This is because lifting asset management maturity is not a short-term exercise. We consider that lifting asset management maturity is important to the sector, and the consumers served by it, however, EDBs need to be afforded an appropriate and reasonable timeframe for achievement.

2.7 Genesis has also commented that it is *"vital for EDBs to have strong corporate governance, a risk-based approach to asset management and expert planning capabilities to provide appropriate oversight and business adaptability"*[8]. We agree with these comments and, in our view, such practices tie back to the overarching issue of asset management maturity and the lift that is required in practices across the sector.

3 Forecasting operating expenditure

3.1 **Partial productivity factor:** We emphasised, in our Submission, the need for the decision on the partial productivity factor to be evidenced-based, and note that several other submitters also expressed this view (the Electricity Networks Association (ENA)[9], Unison[10] and Wellington Electricity Lines Limited[11]). Fonterra[12] supported MEUG in its view that that the partial productivity factor should be set at 1.5%, which it asserts is observed for US distributors[13]. We are unable to support this proposition without a robust analysis of the different jurisdictional, industry and market differences between US and New Zealand EDBs.

3.2 **Impact of higher operating expenditure in substitution for capital expenditure:** We support Unison's view that *"The trend towards software as a service is contributing towards higher operating expenditure in substitution for capex"*[14] and that *"This has implications for the capex and opex IRIS mechanisms, as well as accurate forecasting of opex and capex"*[15]. Furthermore, we agree with its comments that *"the burden of higher operating expenditure is borne by the EDB, but the benefits of more optimised capital expenditure are captured by consumers because these benefits are realised over a longer timeframe than the regulatory period."*[16] The Commission should be mindful of this when setting DPP3.

3.3 **Fire service levies:** The ENA has recommended that fire service levies payable by EDBs become treated as a pass-through cost due to the uncertain outcome of the changes to the levy arrangement and the fact that they are outside of EDBs' control[17]. We support this recommendation.

3.4 **Embedding of cost savings:** Genesis has suggested that *"Cost savings need to be embedded in the opex forecasts upfront to drive EDBs to employ cost management practices seen in the competitive market"*[18]. In order to achieve this, it recommends that a cost optimisation expectation is included in the development of operating expenditure forecasts[19]. In our view, the inclusion of such an expectation would need to be supported by deep and robust analysis, the cost of which could fall well outside of the DPP's relatively low-cost regulatory setting.

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[8] Ibid at 3.
[9] ENA. (2018). *DPP3, April 2020 – Commission Issues Paper; ENA Submission Part One: Regulating capex, opex & incentives*. Para 46, pg 11.
[10] Unison. (2018). *UNISON SUBMISSION ON DEFAULT PRICE QUALITY PATHS FOR ELECTRICITY DISTRIBUTION BUSINESSES FROM 1 APRIL 2020: ISSUES PAPER*. 21 December 2018; para 11.
[11] Wellington Electricity Lines Limited. (2018). *Default price-quality paths for electricity distribution businesses from 1 April 2020 – Issues Paper*. 20 December 2018; pg 3.
[12] Ibid at 6.
[13] MEUG. (2018). *EDB DPP3 reset*. 20 December 2018; para 13, pg 4.
[14] Ibid at 10; para 4.
[15] Ibid at 10; para 4.
[16] Ibid at 10; para 6.
[17] Ibid at 9; paras 66 and 67, pg 16.
[18] Ibid at 3; para 3(c).
[19] Ibid at 3; para 3(c).

4 Forecasting capital expenditure

4.1 **Allowance for innovation:** We agree with the ENA's[20] and Powerco's[21] comments that there is no mention of any capital expenditure allowance or incentives for innovation that will be required in DPP3. As Powerco noted, *"it is important that the DPP appropriately incentivises EDBs to pursue research and development"*[22], a view that we share.

5 Reliability standards and incentives

5.1 **Reliability standards and incentives as a whole:** Our overarching concern is that submitters do not appear to have appreciated the risk that comes with considering discrete changes to reliability standards and incentives in isolation, rather than considering their collective effect as a whole. We remain of the view that the quality standards framework must be considered as an integrated package of measures, rather than assessing the effectiveness of each individually and in isolation.

5.2 **Normalisation:** We note that submitters held varying views on boundary substitution, the term of the reference set and the methodology for normalisation and boundary substitution. We, however, remain of the view that if the 'no material deterioration' standard remains appropriate, then that needs to be supported by methodologies that create stable quality standards, as opposed to methodologies that create swings in outcomes from reset-to-reset.

5.3 Alpine has recommended removing the boundary values and zeroing out all major event days[23]. We do not support this suggested approach because, in our view, this would not achieve a stable and consistent outcome, and would be unlikely to support the 'no material deterioration' standard. Removing boundary values and zeroing out all major event days still requires a mechanism for determining a major event day.

5.4 In order to achieve an element of stability, and in the absence of a fixed reference period (for which we advocated in our Submission), we would support Mercury's view that a 15 year reference set be adopted[24]. This could see the 10-year reference set from DPP2 being used as a baseline to which each subsequent five-years' data is added over time. The baseline reference set would be extended by five years at each reset and, while less stable than a fixed reference set, would at least start to reflect long run, rather than short-run, performance.

5.5 **Health and safety practices:** While we support Vector's view that EDBs should not be held to standards that do not reflect heightened safety practices[25], at the same time we agree with the Commission that step changes should be evidenced[26].

5.6 Mercury has stated in its submission that it does not support making any allowance in the DPP for the impact of live lines policies adopted by EDBs because the EDB, not the consumer, should bear the impact[27]. We disagree with this view, as EDBs already bear risk from the application of a generally low-cost DPP mechanism, which operates from a basic premise that future performance will be broadly in line with historic performance.

6 Other measures of quality of service

6.1 **Power quality:** While we generally agree that the time has come to utilise power quality data being generated, we note that there are no agreed or mandated standards for the advanced

[20] Ibid at 9; pg 4.
[21] Powerco. (2018). *POWERCO – SUBMISSION ON DPP RESET ISSUES PAPER*. 20 December 2018; pg 4.
[22] Ibid at 21.
[23] Alpine Energy. (2018). *Submission to the Commerce Commission on Proposed Quality Targets and Incentives for Default Price-Quality Paths from 1 April 2020*. 20 December 2018; paras 21 to 23; pg 4.
[24] Ibid at 5; pg 4.
[25] Vector. (2018). *VECTOR SUBSMISSION TO DEFAULT PRICE QUALITY PATH ISSUES PAPER*. Pg 10.
[26] Ibid at 1; para C48.
[27] Ibid at 5; pg 5.

metering and associated back-office systems that would likely produce that data. We therefore reiterate that thought would need to be given as to where the power quality is measured. If it is to be measured at the ICP, we suggest that the factors raised in our Submission need to be considered; those being:

(a) whether all advanced meters can provide power quality (at all);

(b) whether all advanced meters can provide power quality in the same way;

(c) whether all advanced meters can provide power quality to the same accuracy;

(d) whether meter data managers can provide the data in volume and at reasonable cost; and

(e) what would occur at legacy metered sites.

6.2 **Retailer notification:** We note Fonterra's comment that *"there is currently no quality metric that measures the performance of retailers in the aspects of performance to reach all customers when communicating planned outages"*[28]. This is an area that is outside of Part 4 of the Commerce Act; however, it is an area that the Electricity Authority could monitor. We have recently observed a number of instances where consumers have not received notifications from their retailer, in relation to a planned outage, despite all retailers being notified in accordance with their use-of-system agreement. To resolve this, EDBs could take on the responsibility of directly notifying consumers of planned outages; however, this would come at an increased cost to consumers, as additional operating costs would be borne by EDBs.

7 Reduction of losses

7.1 We remain of the view that the introduction of incentives for reducing line losses is not required. The Commission could consider more prescriptive reporting of technical losses (as opposed to the broader mix of reconciliation and technical losses reported in Information Disclosure); however, in doing so, should keep in mind, as with any new measures or obligations that it imposes on EDBs at the reset, the compliance costs to EDBs of such reporting and make appropriate allowance for this where necessary.

[28] Ibid at 6; pg 3.