

20 August 2020

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Manager, Price-Quality Regulation
Commerce Commission
By email to feedbackauroraplan@comcom.govt.nz

Dear Dane

Aurora CPP application key issues

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission Key issues paper "Have your say on Aurora Energy's investment plan, Consumer summary, Key issues paper" published 30th July 2020.¹
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.
3. In the following sections MEUG submits on five of the nine key issues listed in the paper²:
 - Options for minimising consumer price shocks.
 - Length of the investment period.
 - The two key issues of Planned power cuts and Unplanned power cuts.
 - Effectiveness of consumer consultation.

In addition, we consider the following is a key issue:

- Aurora's lobbying to have penalties for historic non-compliance reinvested into its communities.

Options for minimising consumer price shocks

4. MEUG supports using a transitional change to tariffs to mitigate price shock to end consumers. The benefits of using a smoothed price path increasing over time outweighs the detriment to the small number consumers that can change their future demand for line services and doing so be rewarded quicker. The number of consumers in a position to

¹ URL https://comcom.govt.nz/_data/assets/pdf_file/0014/222242/Auroras-CPP-Consumer-Summary-Key-Issues-Paper-30-July-2020.pdf at <https://comcom.govt.nz/regulated-industries/electricity-lines/projects/our-assessment-of-aurora-energys-investment-plan>.

² This submission does not consider four key issues: Aurora's ability to deliver on its plan, Impact of the COVID-19 pandemic, Operating expenditure (opex), and Capital expenditure (capex). MEUG agrees these are all key issues and with the suggested approach to managing risks and opportunities for each of those.

change their demand in the next one to two years and hence materially lower costs for all other consumers is likely to be small relative to the majority of consumers that will be facing greater economic hardship than this time last year as the effects of COVID-19 on the wider economy bite.

5. A smoothed increasing price path needs to reflect the relative share of risks between line customers and Aurora. Consumers are willing to pay a fair return on capital to the owners of Aurora including paying the time value of money for a smoothed price path. However, MEUG questions whether paying the 67th percentile uplift above the expected WACC is necessary? MEUG recommends the Commission write to Aurora asking if any of the CPP proposal would be revised if the expected WACC was used instead of the WACC plus the 67th percentile uplift. If Aurora had compelling evidence that the 67th percentile uplift was critical for some proposed investments, then applying that higher WACC to those investments would be warranted provided consumers benefiting from those were prepared to pay the higher cost.

Length of the investment period

6. MEUG is wary of agreeing to a 3-year CPP as it could in effect bind the Commission (and hence consumers) into having to agree a follow-on 5-year CPP. We agree a longer CPP period has a tail with greater uncertainty and that creates challenges.
7. However, we are not sure Aurora would have sufficient time to gather new information and resources to apply for a new 5-year CPP starting 1st April 2024 following an initial 3-year CPP starting 1st April 2021. For this to occur Aurora would have to apply for a CPP around mid-2023 after first starting consultation with interested parties end of 2022. The information and preparatory work before that date would probably start no later than mid-2022 meaning only around 15 months of new data from 1st April 2021 would be available. It is debateable if the additional 15 months data would materially improve, relative to the current application, Aurora's understanding of the price-quality preferences of its customers and the capex and opex plans for the years starting 1st April 2024 and 2025.
8. If Aurora could demonstrate that it would by mid-2022 have new material to consult on for a further 5-year CPP then MEUG agrees an initial 3-year CPP may be worthwhile. However, as explained later in paragraph 13, Aurora's intention not to consult on new regional pricing until 2023 reinforces our view no material new information and the important price-quality trade-off perspectives of consumers will be available by mid-2022.

The two key issues of Planned power cuts and Unplanned power cuts

9. MEUG agrees effective consultation with consumers beforehand and any deviation to plan for planned outages and during management of unplanned outages is essential. It is in Aurora's interest to get this right also to gauge its effectiveness and continuously improve. The Commission should consider asking Aurora to publish as soon as possible after each quarter evidence of monitoring the effectiveness of engagement and a brief narrative of changes made to improve management of outages. We assume this type of information will be part of Aurora's internal management and hence publishing it will not be a material additional cost to the company.

10. MEUG supports Aurora’s compensation scheme to customers where it fails to meet service levels. i.e. unplanned outages not the fault of the customer. This creates an incentive on Aurora to identify and remedy potential risks that have the highest loss of utility to its customers provided the cost of the scheme is borne by the owners of Aurora. The latter caveat is important to keep the management of Aurora focussed rather than dilute the incentive by socialising the cost across all other customers. Socialising the cost across all other consumers unfairly burdens those other customers with a cost that they are not the cause of or may only partially benefit from if at all.
11. A factor to consider is whether the owner of Aurora should bear all or some of the costs of additional planned levels of outages and escalating unplanned outages? The owner of Aurora historically banked dividends and has since benefited by the compounding returns received on those dividends. In contrast the consumers of Aurora’s line services have had a compounding detrimental effect on the level of unplanned outages and by necessity planned outages to restore safety and quality back to historic levels. Had no under-investment occurred the level of both unplanned and unplanned outages to date and the foreseeable future would likely have been less than actual to date and expected over the term of the CPP. MEUG recommends the owner of Aurora compensate customers affected by unplanned and planned outages over the course of the CPP to reflect the fact the owner has benefited by compounding returns on dividends when under-investment occurred and customers face more outages than had the right investment been made at the right time.

Effectiveness of consumer consultation

12. MEUG congratulates Aurora on learning from the lessons of earlier CPP applications by other parties. However, we are disappointed the consumer consultation is still not at a level where individual customers or appropriate grouping of customers at a regional, district and or voltage class clearly know the price-quality trade-offs at stake. This is not all of Aurora’s fault. The failure of the CPP regime to require applicants to clearly quantify the factual and counterfactual, i.e. with and without, effects on future tariffs and quality of supply at as fine a disaggregated level as possible, continues to undermine achievement of the best long-term benefit for consumers.
13. Section 7.1 of the Verifiers report supports our view this issue needs to be considered by the Commission for this application and in our view for the whole CPP regime ahead of any future applications. Extracts from the Verifiers report with relevant text highlighted in yellow are on the next two pages.
14. While the regime framework is a problem and needs to be fixed by the Commission, MEUG is disappointed that Aurora did not take leadership by committing to improving pricing signals early on to enable more granular price-quality information for consumers in the future. The key issues paper notes [p5] “... Aurora has signalled it intends to review its regional pricing and consult with its customers in 2023.” That date would be after an application for a further 5-year CPP could be formulated and consulted on if the Commission agrees an initial 3-year CPP.

7.1 MATTERS FOR THE COMMISSION TO CONSIDER

Generally, the information provided by Aurora Energy on its proposed CPP was sufficient for us to undertake our verification. We are not aware of any information that we consider was omitted by Aurora Energy.

Table 7.1 sets out the matters that the Commission may want to consider when undertaking its own assessment of the information provided by Aurora Energy.

Table 7.1: Matters for the Commission to consider

Topic	Matters to consider	Report reference
COVID-19	Consider the impact of COVID-19 on Aurora Energy's costs and demand faced by Aurora Energy, at least in the short to medium term, as well as the activities that it can undertake in the near term (i.e. due to restrictions on non-essential activities), and whether some mechanism could be used to account for pandemic related uncertainty	Section 1.4
Consumer consultation	<p>If the Commission does not approve Aurora Energy's proposed CPP period but rather prefers that the review period apply, what additional consultation is required to meet the IM requirements</p> <p>Consider whether a clearer counterfactual is required (for example, based on DPP3) to show the improvements in safety and reliability outcomes that are expected from the CPP, and explore with consumers what their thoughts on the identified improvements</p> <p>What is consumers' willingness to pay for maintaining (and potentially improving) safety and reliability outcomes</p> <p>Consider the price impact of the CPP on Aurora Energy's customers at a more granular level to identify whether any customers are likely to receive unpalatable price increases</p> <p>Consider the impact of COVID-19 pandemic and expected economic impact on Aurora Energy's forecasts (including the potential to defer spend) and price outcomes, and on consumer price sensitivity</p> <p>Consider the feedback from the CAP on its experience of Aurora Energy's consultation process</p>	Section 3.3.4
Service measures	What, if any, safety related service measures should be included as a reporting requirement over the CPP period	Section 3.1.4
Unplanned reliability forecast	<ul style="list-style-type: none"> Consider whether preventative maintenance and corrective maintenance have been incorporated into the unplanned normalised reliability model adequately Consider how the historical ratio of pre-normalised reliability to normalised reliability is being calculated and applied to forecast normalised reliability over the CPP and review periods, including as to: 	Sections 3.2.4 and E.4.9

from the WSP findings and will be addressed over the CPP and review periods. We have considered how Aurora Energy plans to address safety in its CPP proposal in section 1.5.7.

In its consultation, Aurora Energy did not present a counterfactual but rather presented its base case as a bare minimum with alternative options that could be added. Aurora Energy attempted to show increase in price outcomes of its proposed CPP compared with it staying on the DPP. However, outcomes were generally based on current information (for example, the percentage of assets at the end of their useful lives in 2019) rather than the expected information at the end of RY24.

MEUG was complimentary on Aurora Energy's 'constructive, pro-active and very clear communications and engagement' but suggested that Aurora Energy should use the DPP as a counterfactual and that it could provide better feedback if disaggregated estimates of changes in price, quality and trade-offs between price and quality were provided by Aurora Energy.⁵⁵ We agree that a clearer counterfactual could be provided and that one based on the DPP makes sense. However, we note that the timing of the Commission decision on DPP3 being 27 November 2019 made it problematic for Aurora Energy to accurately reflect DPP3 as a counterfactual in its consultation material, particularly given that significant consultation on the CPP occurred during September to December 2019.

We also agree with MEUG that better information could be provided by Aurora Energy on changes in price, quality and trade-offs between price and quality. We note that through Aurora Energy's engagement process, most stakeholders confirmed that they are sensitive to the total cost of electricity for their home or business.⁵⁶ In addition, phone surveys indicated high level of satisfaction with current reliability of power supply (86%)⁵⁷. In *Your Network, Your Say* Aurora Energy did not provide details of what the service levels would be under the current DPP (noting the DPP3 timing issues above making this problematic) and what further benefits consumers would obtain under the CPP. Ideally, Aurora Energy should test consumers' willingness to pay for maintaining and potentially improving safety and reliability. In addition, it would have been useful to ask consumers in the response form in *Your Network, Your Say* how much extra they were willing to pay per month to maintain and/or meet safety requirements if they did not support Aurora Energy's proposed CPP plan.

Other key consumer feedback was that:

1. whilst the need for essential work was generally accepted and that network investment needs to be made for renewal and for the future, consumers were shocked at the level of the resulting price shocks and were concerned of the implications for vulnerable households
2. some consumers wanted reassurance that the network would be ready for a low-carbon future and/or greater use/incentives for renewable energy (e.g. solar)
3. the regional price differences were felt to be unfair by those paying most, though once explained, the principle was understood, even if the outcome remained unacceptable

⁵⁵ MEUG letter dated 24 January 2020.

⁵⁶ For example, UMR's quantitative research completed for Aurora Energy in August 2019 stated that close to three-quarters (71%) of residential respondents agreed that they make significant efforts around the home to save as much electricity as possible and 63% agreed that the cost of electricity is worth it for the huge benefits it provides every day to their household. Over half (56%) of residential customers surveyed closely monitor how much electricity their household uses and just over half (53%) are concerned about how much electricity their household uses.

⁵⁷ Aurora Energy CPP Customer Engagement Verifier Workshop, 20 March 2020.

Aurora's lobbying to have penalties for historic non-compliance reinvested into its communities

15. MEUG is concerned if Aurora is successful in its lobbying to have penalties for historic non-compliance reinvested into its communities as this would weaken incentives on the owners of Aurora to meet quality standards at lowest possible cost. If Aurora is successful, then the communities that ultimately own Aurora by way of Dunedin City Holdings Limited that is wholly owned by Dunedin City Council, will have less motivation to hold the Council to account. This should be of concern to the Commerce Commission also because in achieving its Part 4 objectives other strategies and tactics may need to be considered to offset any distortionary intervention by politicians should Aurora's lobbying be successful. Better to nip the proposed distortion in the bud in the first place.

Yours sincerely



Ralph Matthes
Executive Director