Orion

10 December 2020

Dane Gunnell

Manager, Price-Quality regulation

Commerce Commission

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By email: feedbackauroraplan@comcom.govt.nz

Dear Dane

Submission on Aurora CPP draft decision (the Paper)

Introduction

1. Orion welcomes the opportunity to submit on the draft decision for Aurora's CPP.

Summary

2. We are concerned that the limited timeframe provided to submit on the substantial reasons paper and draft decision undermines due process.
3. We submit that a consecutive CPP should be possible following an initial CPP regardless of the application timing in the regulatory period.
4. We submit that Strata's analysis is often too high level, and this may result in an inaccurate assessment of Aurora's circumstances.
5. We acknowledge that the customised nature of a CPP may mean that an alternative CPI forecast can be used in the Commission's decision but that this approach should not apply when coming off the CPP onto a DPP if not aligned with a DPP reset date.
6. We submit that the Commission should reconsider its approach to the CPI forecast and its application as part of the next IM review.

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Submitter opportunity to digest and submit limited in timeframes provided

7. The Commission's CPP draft decision for Aurora is an important decision for the long-term sustainability of electricity distribution in the Otago region.
8. The quantity and technical nature of the draft decision means that time is needed to understand and digest the draft decision in any comprehensive way.
9. We submit that potential submitters have not been afforded an appropriate timeframe in which to make their submissions and therefore that this undermines due process.
10. On that basis our submission focusses on broader points.

EDBs are prohibited from proposing a second consecutive CPP within the same DPP regulatory period

11. Aurora applied for its CPP in 2020 during DPP3 and sought a 3-year CPP period.
12. Section 53Q(3) of the Commerce Act states that "A supplier may make only 1 proposal during a regulatory period and may not make a proposal within the 12 months before a default price-quality path is due to be reset." The Commission's view is this means Aurora cannot apply for a CPP in 2025. The Commission, in its CPP determination as per Section 52P(3)(b) of the Commerce Act, can specify the regulatory period and it's not clear that this must relate to the DPP period.
13. Aurora has proposed, and the Commission has considered a 3-year CPP period[1]. Should Aurora wish to apply for a consecutive CPP a surprising result, given the Commission's view of the drafting and the timing of Aurora's proposal, in year 1 of the DPP3, is that if a three-year CPP is granted there would be "a gap "[2] in 2025, a type of no-mans' land, since Aurora cannot apply again until 2026 (DPP4).
14. In essence Aurora would only be permitted to submit proposals for consecutive CPPs only if either: (i) its CPP broke across two DPP regulatory periods, or (ii) it applied for the CPP during DPP2.
15. We submit that application for consecutive CPPs should be possible and that the Commission should consider addressing this.

[1] Subpart 4(1) 5.4.4 duration of regulatory period, Electricity Distribution Services Input Methodologies Determination 2012

[2] B13 page 149, 2.5.3 The type of regulation that would apply to Aurora in years four and five if it were not on a CPP—if Aurora's CPP expires after three years it may potentially revert back to the default price-quality path that did not suit its needs previously, Aurora has signalled its intention to apply for a second CPP. However, the Commerce Act appears not to allow them to do this until 2026, so if we determined a three-year CPP there would be a gap.

Strata's analysis is a top-down, desktop review that relies heavily on assumptions and benchmarks – this can lead to simplistic outcomes

16. We submit that the Commission should be wary of desktop benchmarking assessments of forecast expenditure for an individualised CPP application.

17. Many of the cost categories available to EDBs leave some discretion/judgement about what category to place a cost in. This is particularly so for System Operations and Network Support (SONS) and Business Support (People). This is because EDBs business models have differences.

18. The Commission may recall a similar discussion following the Alpine breach report where Strata came to a conclusion about Alpine's level of investment in asset replacement and renewal versus depreciation[3]. Orion applied Strata's desktop assessment approach to our investment profile which revealed a failure to identify the significant post-quake asset investment period. Other expenditure categories needed to be included to (a) show the post-quake investment period and (b) reflect the true investment comparison to depreciation. Strata's assessment was too simplistic.

19. Aurora's SONS forecast has been assessed in isolation from the Business Support (people) forecast and against EDBs not facing the investment challenges of Aurora. We submit that the Commission may have underestimated the level of human resource required to complete the programme of work necessary for Aurora to improve its network performance. A greater reliance on the verifier's more comprehensive and detailed assessment of Aurora's proposal may have resulted in a more appropriate outcome.

Based on Strata advice the Commission's draft CPP opex allowance is set at <u>a level lower</u> than DPP3

20. We are surprised that a CPP application for an uplift in investment has resulted in a CPP opex allowance ($207.77m) that is set lower than the DPP3 opex allowance ($241.25m[4]) for Aurora.
21. We submit that the substantial uplift in capex sought by Aurora would intuitively require a commensurate uplift in opex especially for the human resources to support planning and delivery. We submit that this requires further review and consideration by the Commission.

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[3] Quality non-compliance Report, Alpine Energy Limited's noncompliance with the DPP quality standards for the 2016 assessment period. A report for The Commerce Commission 6th November 2018, Figure 24- https://informer.oriongroup.co.nz/sites/legislation/regframework/StrataAlpineBreachReportNov18.pdf

[4] See table A1 DPP3 reasons paper

CPI forecast

22. The Commission have stated that Aurora may propose an IM variation to allow the use of a more up to date forecast of CPI to set its price path. This is because the current IM drafting only allows the Commission to use the forecasts of CPI from prior to the date the WACC rate was determined which was 25 September 2019.[5]

23. During the 2015-2016 IM review the Commission made a conscious and documented decision to align DPP and CPP WACC, and in doing that considered it consistent to ensure CPI forecasts were also set at the time the WACC was set. The Commission specifically said;

> *"Forecast revaluation gains under a DPP or CPP are based on forecast CPI. For consistency we would therefore need to ensure that these forecasts are consistent with the time at which the WACC is determined. For example, when determining a forecast of revaluation gains for a CPP, we will use CPI forecasts made at the time the DPP WACC was determined. This earlier CPI forecast could be a number of years prior to the start of the CPP but it ensures consistency with our economic principle of ex-ante FCM."*

24. We submit that the Commission's suggestion for an IM variation to allow the use of a more up to date forecast of CPI is inconsistent with their previous reasoning. However, we do acknowledge that the customised nature of a CPP may mean that an alternative CPI forecast can be used in the Commission's decision but that this approach should not apply when coming off the CPP onto a DPP if not aligned with a DPP reset date.

25. Despite the above points, Orion submits that the Commission's current approach to setting the CPI forecast, and its application to setting the maximum allowable revenue and the growth (i.e. indexation) of regulated revenues over the regulatory period, has resulted in revenue under-recovery over successive regulatory periods.

[5] Aurora draft decision points J41-J43

26. We submit that a real return on equity is not being achieved by EDBs because two key conditions are not holding true in practice;

    (a) The inflation forecast is an unbiased estimate of the rate of inflation that would be used to index the RAB; and

    (b) EDBs have a means to manage any mismatches between the real return on debt allowed and their nominal cost of debt

27. We submit that the CPI forecast is an important topic for consideration at the next IM Review due to the inflation forecasting and debt compensation issues raised in point 25.

Concluding remarks

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

Yours sincerely

Dayle Parris

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