

Meeting Date: 22 June 2018

THE COMMERCE COMMISSION'S FOCUS ON ASSET MANAGEMENT

SECURITY AND RELIABILITY COUNCIL

The Commerce Commission anticipates increasing its focus on the asset management of electricity distributors. Asset management has direct impacts on the reliability experienced by consumers, so is of interest to the Security and Reliability Council (SRC).

Note: This paper has been prepared for the purpose of the SRC. Content should not be interpreted as representing the views or policy of the Electricity Authority.

The Commerce Commission's focus on asset management

On 9 November 2017, the Commerce Commission (Commission) released an open letter setting out its priorities for the electricity distribution sector for 2017/18 and beyond. Among those priorities, asset management was singled out as a key focus area for the Commission. Asset management is very closely aligned with the SRC's interest in reliability.

In its open letter, the Commission noted:

"Sound asset management is an integral part of ensuring that distributors improve efficiency and provide services at a price and quality that reflects the demands of electricity consumers. However, assessing whether distributors' asset management decisions result in over- or under-investment is a challenge, given the typically long lifetimes of network assets. In addition, there can be a significant lag between assets deteriorating and quality reducing, and it can be difficult to set leading performance indicators that appropriately reflect the risk of poorer quality in the future."

"As electricity distributors' asset management practices continue to mature, we would expect them to be increasingly focusing on, among other things:

- the health and criticality of their assets;
- investment 'sufficiency'—the extent to which they are re-investing in assets at a prudent level; and
- appropriate levels of network resilience—the ability to maintain and restore electricity supply to consumers, particularly following high-impact, low-probability (HILP) events, such as earthquakes."

Given the SRC's interest in these reliability-related matters, the SRC secretariat invited the Commission to present on this topic at the 22 June 2018 SRC meeting. Representatives from the Commission will attend, present a selection of the attached slides and be available to answer questions from the SRC.

The Commission notes they are very limited in their ability to discuss any open investigations of distributors not meeting their reliability-related targets.

Questions for the SRC to consider

The SRC may wish to consider the following questions.

- Q1. What further information, if any, does the SRC wish to have provided to it by the secretariat?**
- Q2. Has the SRC received information sufficient for it to reach any preliminary conclusions about the adequacy of the levels of reliability (including resilience) provided by distributors?**
- Q3. What advice, if any, does the SRC wish to provide to the Authority?**

Commission focus: asset management

Ahead of Security and Reliability Council meeting

22 June 2018

Nick Russ, Simon Wakefield and Tim Hewitt

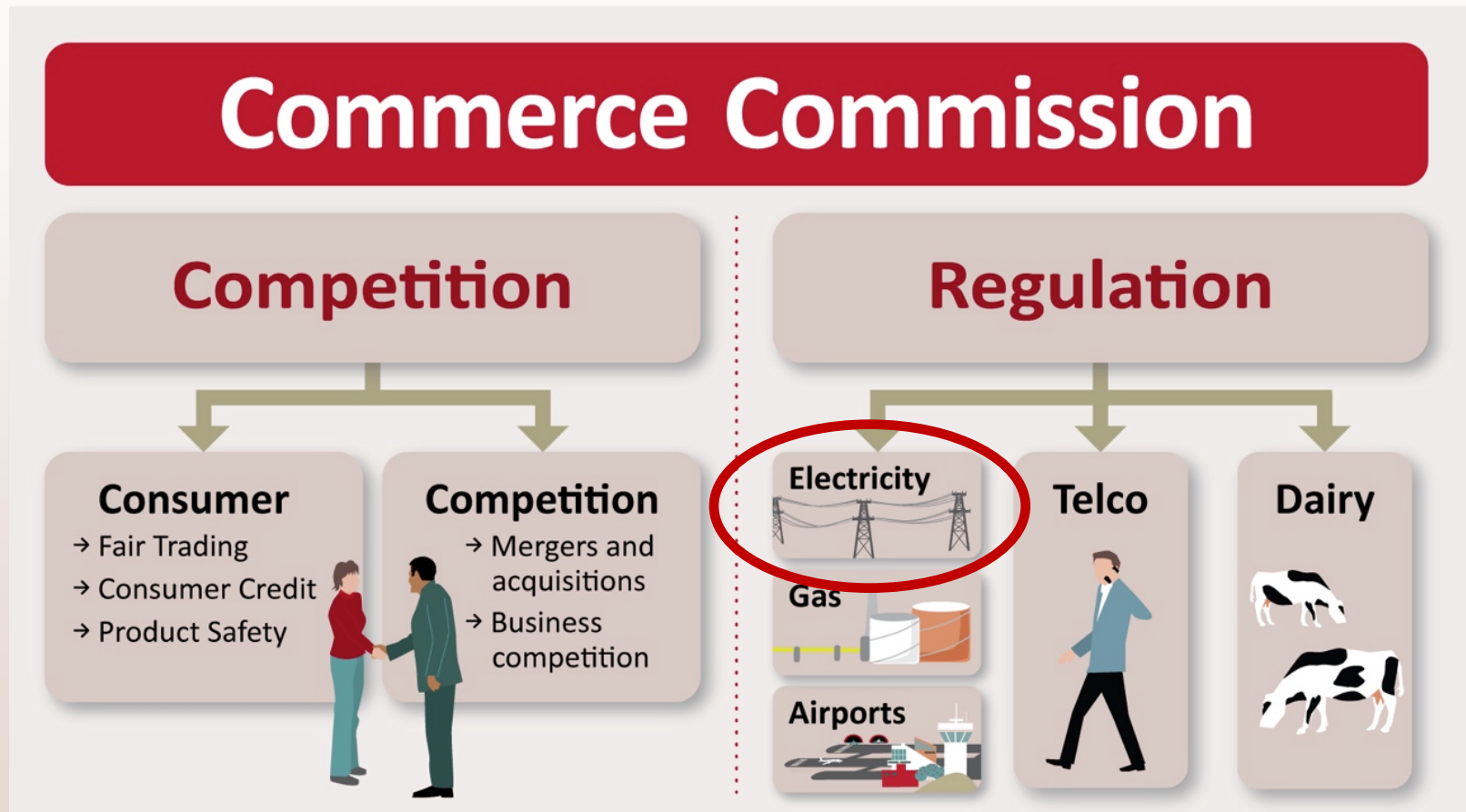


Outline

- We are the economic regulator of monopoly utilities
- We have renewed our focus on asset management
- We want industry to lead asset management improvements but will help facilitate with our range of tools:
 - Price-quality regulation
 - Information disclosure
 - Influence and strategic leadership



The Commerce Commission



Natural monopolies and regulation

- Network segment of energy utilities tend to be ‘natural monopolies’
- Society benefits where only one natural monopoly supplies the relevant market
- Network segment of energy supply chain often (but not always) split off from other more competitive segments

Unregulated monopoly and consumer harm

- Unregulated natural monopolies cause risk of consumer harm
- Economic regulation's main aim is to mitigate these risks
- First developed in early 1900s in the US
 - This field has developed over more than 100 years
 - It has evolved into different variants, also reflecting different operating environments

Economic regulation causes important risks

- Price regulation aimed at mitigating the problems of monopoly can give rise to important consequential risks
 - Investment hold-up
 - Regulatory gaming caused by information asymmetries
 - Quality degradation
- All three risks are closely related to asset management

Asset management focus

- Asset management is the core function of the businesses we regulate; and
- Asset management and resilience are the key determinants of the quality (principally reliability) that consumers receive and also helps determine the efficiency and direction of the business.
- So, improving asset management is closely aligned with our purpose and strategy, promoting the long-term benefits of consumers.
- Increased focus on asset management is now possible having set the rules (input methodologies) and evaluated profitability levels.
- Open letter to stakeholders (November 2017) reinforced this:
 - <http://www.comcom.govt.nz/regulated-industries/electricity/our-priorities-in-electricity-distribution/>



Tools for improving asset management

- **Price-quality regulation, information disclosure regime** (including our analysis and publications), and our **influencing role** work together to incentivise better asset management practices
- Asset management was important to past decisions, such as our emphasis on incentivising sufficient investment, but we are now refining our consideration of asset management to a more detailed and expanded level across our full range of tools
- **Price-quality regulation:** quality standards and an appropriate weighted average cost of capital (including uplift) provide a counter-balance to cost-minimisation incentives
- **Information disclosure:** disclosure and our analysis of the information reveals good and poor practices, particularly through asset management plans and core asset management data (eg, asset condition)
- **Influencing role in the sector:** working with lines businesses to promote the long-term benefits of consumers, beyond our typical regulatory tools



Price-quality regulation

Resetting Transpower's independent price-quality path

- To be finalised in November 2019, taking effect from 1 April 2020
- Transpower has voluntarily engaged a verifier (independent expert engineer) to review its price-quality path proposal
- We expect further asset management improvements in next proposal and subsequently:
 - Set of risk-based asset health measures
 - Asset health and criticality framework
 - Clear track record of customer preference consultation
 - Non-recurring expenditure identified through clear process and documentation
 - Clearly modeled recurring expenditure
 - Consideration of pricing impacts



Price-quality regulation

Resetting the default price-quality paths for distributors

- Applies to 17 distributors (others meet community-ownership criteria)
- To be set in November 2019, taking effect from 1 April 2020
- We have not yet chosen **our approach to forecasting expenditure**, which will be a key interaction with asset management and resilience
- We are planning an increased focus on **setting the quality standards**, including potential consideration of other aspects of quality



Price-quality regulation

Recent and future customised price-quality paths

- Current customised price-quality paths (Orion, Wellington Electricity, and Powerco) have addressed different aspects of asset management: recovery, resilience, replacement and renewal investment.
- Aurora is expected to apply for a customised path, focused on a large investment required for an ageing network
- The ability to apply for customised paths allows for additional scrutiny of asset management interventions that do not fit within the low-cost default path



Price-quality regulation

Investigations of quality standard contraventions

- In investigating the causes of quality standard contraventions, we consider asset management, including asset data management, replacement and renewal planning and investment, and the full lifecycle management of assets.
- Currently investigating quality standard contraventions by Vector, Aurora, Transpower, and Alpine.
- 2018 contraventions of the quality standards, which we will investigate include Vector, Aurora, Wellington Electricity, Unison, Horizon, and The Lines Company.



Price-quality regulation

Some other current challenges for price-quality regulation

- **Changes to health and safety practices:** these changes appear to be affecting the reliability and possibly costs of some lines companies, particularly those that have largely ceased live lines work. We are actively considering this issue, including consideration of it within investigations into quality standard contraventions.
- **Customer service lines:** There are challenges in the industry in how to treat customer service lines. Currently, the cost of maintaining customer service lines cannot be attributed to the regulated service under our regime, although some lines businesses may want to. We have been discussing this issue with stakeholders, including the Electricity Networks Association and the Ministry for Business, Innovation, and Employment.



Asset management plan reviews

- We have undertaken a high level review of distributors' 2016 asset management plans, to be published shortly.
- We are beginning a review of the distributors' 2018 asset management plans, which will be more in-depth in line with our current focus on asset management. This review may include a number of different pieces of analysis, focusing on different areas of asset management practice. We have particular interest in investment sufficiency, resilience, asset health and criticality, asset condition information systems, and risk.
- We also review Transpower's primary publications, such as its Integrated Transmission Plan and provide feedback to Transpower.



Information disclosure

Improving accessibility to disclosed information

- Over the past two years we have been focused on improving the public accessibility of the data disclosed by our regulated suppliers, including electricity lines businesses.
- This is resulting in an increase in the amount of performance analysis we undertake for internal and external purposes, now publishing a range of material from simple-to-digest charts of basic information, through to complex analysis.
- Key recent publications include:
 - [One page summaries](#)
 - [Performance accessibility tool](#)
- There's more to come: watch this space!



Asset management fact-finding visits

- Staff have visited around half of the electricity distributors in recent months, with the primary focus on asset management.
- Allows us to appreciate the specific circumstances of different distributors and their different asset management strategies responding to those circumstances.
- We are seeing differing capability amongst individual networks.
- While we haven't published a report on these visits, they inform the other work we do, such as our review of asset management plans.



Facilitating sector advancement of criticality

- We are engaged in industry discussions on criticality frameworks in a number of ways, including presenting at the Electricity Engineers' Association Conference (21 June).
- Advantages of asset criticality frameworks include:
 - Providing estimates of asset outage impact
 - Informing investment decisions, timing, and prioritisation
 - Supports consultation and consideration of investment and reliability options



Other reviews of networks and events

- Where appropriate, we encourage, request, or are directly involved with reviews of networks and network events or request other information relevant to the asset management or resilience performance of lines businesses.
- There are varying degrees of formality.
- For example, we are observing in Aurora's current 'state of the network' review and have had input into the terms of reference and scope of this work.
- We take a holistic approach to networks of concern, keeping overall interests of consumers front and center.



Asset management focus

Key points

- Asset management is a fundamental of distributors
- Increased focus on asset management now that we have set the rules and evaluated profitability
- We want industry to lead asset management improvements but will help facilitate with our range of tools



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