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PRESENTATION TO THE COMMERCE COMMISSION ON ODV

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Good afternoon Madam Chair and Commissioners. I'm Warren Moyes, Chairman of the Electricity Networks Association. Assisting me are Alan Jenkins, the Association's Chief Executive, and Stuart Shepherd of LECG. Stuart will deliver the main part of our presentation after my introductory comments.

First, I'd like to comment on one of the original purposes of ODV. It was conceived in the early '90s when there was a concern among officials that the wider lines industry, including Transpower, suffered from so called 'gold plating' that should be eliminated by tight valuation rules designed to write off unnecessary, redundant or premature investments. We are now witnessing concerns that the transmission system, at least, is suffering from serious underinvestment over the past decade. For example, I noted over Easter that Transpower's Chief Executive sees a significant risk of power supply problems in the near future if elderly lines into Christchurch are not reinforced.

Similarly, there is no evidence of gold plating of the rest of the lines industry, where our current physical asset base still largely reflects the combined pressures for national reticulation and the very rapid demand growth experienced from the 1940s through to the 1970s.

I'll illustrate this with some statistics.

- In 1944, the precursors of today's lines companies owned 39,000 circuit km of lines, connecting to 465,000 consumers.
- By 1984 they owned 152,000 km of lines, connecting to 1.17 million consumers.

- In contrast, today – 20 years later - the lines industry has just 144,000 circuit km of lines (significantly down from its 1984 peak) connecting to 1.8 million (that's 54% more) consumers. This shrinkage of some networks reflects factors such as urbanisation and – we think – embedded generation.

Paralleling this slow-down in physical network expansion, over the past two decades energy loads have risen very rapidly. Energy deliveries by lines companies have risen by 167% over the 20 years since 1984. All this gives a very strong message that lines companies have not been building indiscriminately but that the loadings on existing assets have risen very considerably. Using ODV to drive out fat from the lines industry is, in our view, unjustifiable. There seems to be fairly reasonable evidence that there is now no such fat.

However, the use of ODV under the Commission's targeted control regime appears to have a new purpose, which is to provide an asset value that may be used in investigating a threshold breach, and perhaps for setting prices if the Commission intervenes after a breach. If valuations are used for such purposes they will need to reflect a comprehensive view of the assets required by a lines company to deliver its distribution services. The draft Handbook does not give us confidence that this will be the case, and Stuart will elaborate on this point.

Another aspect of ODV that is inconsistent with the realities of business is its very limited flexibility in attributing values to particular assets. Lines companies in heavily urbanised areas frequently have had to, and will continue to have to, make judgements on the siting of poles and cables to coincide with major public works schemes, such as the construction of new roads. The optimal configuration of a network in these circumstances is not driven by the simplistic 'straight line' ideals of ODV but by practical realities. Optimising down to a greenfields configuration is not reasonable.

As another example, considerable effort over the past 18 months has been put into developing the so-called 'roadshare' arrangements with local bodies, the telecommunications industry and the gas industry. These arrangements involve urban network operators notifying each other when one is planning to open a road or dig a trench, so that traffic disruption is minimised, damage to road surfaces is reduced, and

savings can be achieved when the same works are used by several utilities. To support this sensible regime, a lines company is likely to need to carry higher stocks of cables and components, and may also have to make pragmatic decisions to advance works by several years to coincide with the timing of open trenches and/or major road closures. However, higher stocks, premature investment and hidden savings to road users and other parties are not recognised under the ODV rules.

Outside the main urban areas, lines companies need to be able to respond both to the costs of alternatives and to practical realities. A lines company operating in a dairying region is under strong local pressure to provide reliable supply to the seasonally confined dairying load, while a company with a large pumped irrigation consumer base has similar issues to contend with. When a lines company has to meet the needs both of dairy farmers and another dependent group, such as irrigators, these issues may compound. Again, the rigidity of the ODV rules doesn't accommodate these different drivers easily.

Similarly, in some circumstances back-up generators can be used to protect vulnerable farmers and others from lines being knocked down by storms or other events. In other circumstances, the numbers of vulnerable consumers with no such protection may mean that a lines company has to live with the reality of higher inventories and more stringent inspection and renewal policies. The draft ODV Handbook would not treat these two approaches consistently. Stuart will suggest that the Commission allows greater use of actual costs in arriving at valuations to address such issues, and I'll leave it to him to elaborate on this.

There are other anomalies associated with applying a single set of ODV rules to such a diversified industry. As a further example (while data on consumption by consumer groups has become obscure over the past decade) we understand there is a more-or-less linear temperature-related rise in domestic electricity usage going south. As examples:

- A household in my own company's Northland territory might use around 6,000 to 7,000 units a year, while a similar household in Dunedin will use 10,000 to 11,000 units.
- In a larger urban centre companies tend to have much larger individual commercial and industrial loads. Thus, the average

Auckland commercial user in 1991-92 (the latest year we have this data for) consumed 54,300 units, while the average in Nelson was 37,900 units.

These differences, and others like them, will invariably mean that some companies face higher capital costs per unit conveyed than others do, due to differences in end use loads, more variable peaks, and so forth.

Given this degree of variation in a number of different elements that influence a lines company's perceived efficiency and appropriate costs, it is hard to see a single mandated version of ODV resulting in consistent, reliable valuations across the wide range of individual situations encountered in the New Zealand lines industry.

A final point I wish to make involves the fundamental importance of focussing first on maintaining a secure, sustainable flow of electricity to consumers. The Commission may see its asset valuation process become increasingly important as a tool for ensuring that regulation is not impeding necessary investment. As it stands, the draft ODV Handbook is itself likely to do just that, as it omits assets necessary to deliver the distribution service, and sets prices for many assets that lines businesses are not able in practice to achieve. Lines companies will be reluctant to invest where the regulator does not recognise what they believe to be prudent expenditure.

Over the course of the conference our members will provide you with practical examples of matching the rigidities of ODV with the realities of power supply.

I'll now hand over to Stuart Shepherd for the second part of our presentation.