ENERGY NEWS
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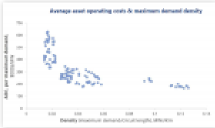
Amalgamation no silver bullet for EDB costs

Felicity Wolfe - Mon, 03 Sep 2018



Amalgamation is no silver bullet for increasing the efficiency of the country's smaller electricity networks, a new study suggests.

The report by TDB Advisory found that there were some efficiency gains among network firms with high numbers of connected consumers.

When only looking at total connection numbers, the work found that amalgamating distributors with fewer than 50,000 customer connections gave apparent efficiency gains in the range of $46 million to $56 million per annum. The mean value of that was equivalent to $123 per affected customer connection each year.

The firm says those apparent gains rose to between $83 million to $103 million – or an average of $132 per affected customer connection per annum - if the smallest electricity distributor had at least 100,000 customer connections.

But it says the efficiency gains "disappear" when the results also take network density – numbers of ICPs per kilometre - into account. "Customer density has a bigger impact on predicting asset operating cost than does size and the impact of size (once density is allowed for) is not statistically different from zero."

TDB notes that around two-thirds of the systematic variation of costs between EDBs can be explained by density and size. "However there remains another one-third which cannot be explained by these factors. Further work by the Commerce Commission to understand the reason for these cost differences is recommended."

Amalgamation debate

TDB – a corporate finance and economics advisory firm - was commissioned to investigate the potential benefits of network amalgamation by an informal group of five generator-retailers and seven distributors. It considered different network's density, energy delivered, maximum demand, and number of customer connections.

The resulting report has been sent to the Government's Electricity Price Review Panel, the Commerce Commission and the Electricity Authority.

The firm notes that the past 25 years has seen several acquisitions and mergers among electricity distributors which reduced their number from an original 44 to 29 - or 26 when joint management arrangements are considered.

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Factfile information

Organisation	Commerce Commission

Of those, 12 serve fewer than 25,000 customer connections while only four distributors serve 100,000 or more ICPs and only three of the four largest EDBs are directly exposed to equity capital market disciplines through either share market listing or private ownership.

As such the sector has been subject to speculation – from the wider industry, politicians and others – that consolidation would lower consumer costs by increasing the firms' economies of scale and efficiencies.

Election topic

The issue became a hot energy industry topic in the run-up to last year's election. At a debate last August then-Energy Minister Judith Collins said she was concerned that having 29 lines companies was creating inefficiencies and ACT leader David Seymour described the smaller firms a "a cottage industry".

The Greens energy spokesperson Gareth Hughes suggested small firms would struggle to get their heads around new technology.

The Electricity Networks Association – which was not party to the commissioning of the report – does not have a view on whether there are too many or too few electricity network companies in New Zealand.

But chief executive Graeme Peters says despite people "saying for years" that there are too many network providers, the TBD report shows "there is very little to be gained from amalgamation".

Although distributors are "very interested in saving money in the interests of consumers" saving $20 million a year needs to be considered in the context of "total lines revenue of $1.7 billion a year, and total expenditure - capital and operating - of $1.2 billion a year".

"The TBD data also doesn't include transaction costs, which would be in the tens of millions of dollars."

Commission data

TDB says it used the "considerable information" EDBs are required to provide the Commerce Commission as part of their regulatory requirements, which provided a lot of data on their efficiency.

While its report is at a high level – it says "little empirical analysis" has previously been done to test whether varying levels of efficiency in the distribution sector might be explained by entity size, and hence might be reduced by fostering amalgamation.

It notes that even when splitting out cost factors, customer density factor remains the most important influence.

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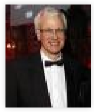

Richard Tweedie retired as managing director of Todd Energy in 2010 having taken the company on an incredible journey of growth and wealth creation over 23 years. During this time he significantly carved out a path to allow competition and commercial innovation to flourish in the upstream and downstream New Zealand energy sectors.

Tweedie studied law at Victoria University in Wellington...

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Bryan Leyland

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Location	Waikato River

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Revenue 2017	$99.5m
Ownership	Central Lakes Trust
Description	Electricity generator
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It says that even if asset operating costs were divided into into capital-intensive and labour-intensive activities the results are broadly the same.

Size has a "small negative influence on labour-intensive costs", but customer density remains the most important factor.

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Anonymous
Mon, 03 Sep 2018

new

Fudging the numbers

I must be dense as I don't see how $83-100m of annual savings (which is roughly an NPV of $1b) disappears when taking into account customer density. Just thinking through this logically - you have 29 lines companies each with a Board of Directors, CEO, CFO, GM Networks (or equivalent), and so on. There would be significant governance cost savings in amalgamation just in these costs (and related corporate costs e.g. auditors, lawyers, accountants, regulatory advisors, annual reports). I would not however anticipate significant reductions in numbers in engineers, PMs etc as the workload in network asset management would not diminish significantly with amalgamation. Then take into account the disparity of network standards, equipment standards and corporate IT systems between all these companies - which is great for equipment & software suppliers and consultants but not for customers (including retailers and other nationwide organisations that have to engage with multiple lines companies in their business). With more standardisation, the reduced no of lines companies would have greater buying power and further cost savings to be had. Yes there will be several million dollars of transactional costs that would be incurred to enable these amalgamations - but these are an upfront cost - and netted off ~$1b+ NPV benefits. Disclaimer: Playing devil's advocate here - maintaining the status quo would be in my best interests!

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Who paid for the report
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Who paid for the report

After some time in this industry I've realised the report normally comes up with the result that suits the agenda of the party that commissioned it..... to that end... who paid for the report.

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