KING COUNTRY ELECTRIC POWER TRUST

SHAREHOLDER FOR THE CONSUMERS IN THE LINES CO LTD & KING COUNTRY ENERGY LTD

TRUSTEES: Brian Gurney, Graeme Cosford, Uwe Kroll, Norman Annand, Robert Carter

THE LINES COMPANY LIMITED – SUBMISSION 2011

Demand charging is a form of "cost reflective pricing" designed to encourage consumers to contain their peak demand for electricity.

Cost reflective charges do not necessarily result in increased revenue as the prime objective is to shift load away from high demand periods and slow the need for increasing the load capacity of network assets.

TLC does have a need to increase revenue to replace 40% of their ageing assets over the next 10 years, in 2010 $'s an average capex requirement of ($150million x 40% / 10years) $6 million p.a. plus CPI adjustments.

TLC has a stated policy of replacing these assets from revenue and as a shareholder KCEPT have consistently expressed the opinion that because these new **assets have a projected life of 30-50 years therefore funding should be a combination of revenue and debt in order that the current generation of consumers do not bear the full cost of replacement.**

It is also the opinion of the KCEPT shareholder that **TLC have muddled the desire to shift load and the need to increase revenue with the result that the greatest burden of cost increases has fallen on those consumers who have a high seasonal load and are unable because of lifestyle, cold climatic conditions or the nature of their business to shift consumption patterns and these consumers are paying the highest costs and TLC need to review this cost imposition by reviewing the tariff structure and finding a more equitable balance.**

It is the opinion of KCEPT that the Sapere study because of its narrow brief, focused on changes to the current tariff regime and did not fully examine the structural problems of TLC's charging regime and as a result "fiddled with what we have" rather than addressing the framework in a broader sense.

The NZIER report took a wider view and came to some interesting conclusions;

- The TLC charging regime is probably unique in the world and there for is totally untested internationally
- Cost reflective charging or capacity charging is in common use with the objectives noted above
- A deferred pricing signal charged to customers six to nine months after the event is an inefficient means of encouraging load shifting
- A "fair and equitable" pricing regime has an essential component that consumers must know what load they are drawing and when they need to shed demand to manage their energy costs
- If the objective is to charge in a consistent way then all consumers must be measured in the same way and charged on the same pricing schedule
- **KCEPT submit the only way these pricing flaws can be addressed is for all consumers to have installed meters that have real time displays/signals that they can react to and manage their energy costs; until these assets are in place all customers should be charged on KWhrs or assessed demand as although the latter is not perfect it is at least consistent**

MEMBER OF ENERGY TRUSTS OF NEW ZEALAND

PO Box 421, TAUMARUNUI 3946 Phone: 07 8959471 Fax: 07 8959041
Email: kcept@xtra.co.nz Secretary: Tessa M Stewart

- A small sample of customers in a Focus Group discussion expressed the view that a fixed monthly charge was preferable to a variable monthly charge, however **they were unlikely at the time (standard monthly billing preceded the introduction of demand charging) to have grasped the company's intention to take a peak demand reading during winter and apply the data from the next April for a further twelve months; the very delayed and inefficient cost reflective signal coupled with the high consumer cost for consistency requires TLC's review as to whether this is ethical behaviour by our business**

In studying both reports carefully as shareholders with a prime focus on maintaining or preferably increasing shareholder value, Trustees have taken a over arching view of "demand charging" and asked the these questions;

1. Is it an effective and efficient charging regime?
2. Is it a "fair and equitable" charging system to our consumer/beneficiaries?
3. Is it cost effective?

Assuming that the tariff is to shift demand load rather than increase revenue, as is stated in the company's objectives;

- **PRICING EFFICIENCY**; Based on TLC data demand has reduced but the efficiency of this signal is poor due to the lack of appropriate metering and the long delays before the signal is reflected in pricing
- The system thus has severe design issues
- **FAIRNESS & EQUITY**; The lack of appropriate metering supplied and paid for by the company and the mixture of "assessed demands", time of use meters and negotiated rates makes the charges a "lottery of chance" for customers, which is not "fair and equitable"; the installation of TOU meters in particular has created large inconsistencies in amounts billed and has been the source of much protest by consumers
- The lack of fairness and equity is reflected in the Customer satisfaction surveys (table 1 attached) that has seen a steady decline since the introduction of demand charging
- **COST EFFECTIVENESS**; Demand charging is being supported with a TLC dedicated billing system, the need for a replacement of metering assets, an enhanced customer service centre to adequately answer customer enquiries, a greater management input to resolve issues raised by disaffected customers, an increased customer relationship budget to counter public criticisms and a significantly increased financial budget to provide for the above
- The additional actual costs may be known to the directors but are probably in the order of;

Independent billing	= $600k net increase annually
Replace all meters @ $200+$50 installed (currently proposed)	= $4-5 million total cost
Computer system to process data for accurate profiling and billing	= $2 million estimated cost
Customer service call centre	= $500k annually
Customer relationship costs	= $100k annually
Management expenses	= $100k annually
Financing costs for the above	= $600k

  Total potential cost for a functional demand charging system is in the order of $6-7 million for additional capital and $2 million approximately ongoing costs.

- **COST EFFECTIVENESS**; Between 2007 and 2011 the network revenue has risen from $21 million to $31 million per year whilst capital expenditure has remained in the $6-7 million range, the cost of $8-9million to raise $10 million additional revenue from consumers is not cost effective and a more simple tariff system would provide additional funds for asset renewal of the network business
- Given the core company network business requires urgent upgrading the KCEPT **shareholder submits that there should be a refocus of business activity to improve the asset quality, increase service, reduce outages and reduce line losses that have increased at an alarming rate; there appears no need to further increase revenue as proposed by the company it just requires existing revenues to be applied more cost effectively; (TLC income and expenditure summary attached)**

- **It further submits that the diversification strategy of developing a larger contracting business, increased metering stock and mini hydro generation assets are placed on hold as they are diverting financial and management resources away from the core business without commensurate commercial returns from the high business risk being assumed**
- TLC Statement of Corporate Intent sets the commercial hurdle of 9.6% for non-core assets this is a minimum of 2% above the network WACC of 7.6% and non network operations must be able to afford their own resources; **the 2011 annual accounts indicate that these thresholds are not being met and are being sustained by network revenue and resources, hence the recommendation above**
- **SUSTAINABILITY;** The network business is characterised by ageing assets, low growth and no large urban populations to support costs

The company plans to increase prices until the regulated return of 8.4% is reached, a further 17-18%.

KCEPT contends that because some 35% of the network was built with the help of government subsidies and in all likelihood many areas have never provided a full commercial return since their construction, to extract a full return now will make the service unaffordable to many consumers.

If consumers are driven off the network by high prices the remaining customers will need to pay more and the company enters in to a downward spiral of reduced revenue and stranded assets.

The network requires increased growth, improved capability and cost efficiencies to remain sustainable.

KCEPT SUBMIT EVERY EFFORT SHOULD BE MADE TO FIND SYNERGISTIC EFFICIENCIES BY EITHER;

A) **Mutually beneficial mergers or acquisitions**
B) **Initiate a company to manage several mid North Island networks that retains Trust ownership and sovereignty but delivers a more efficient cost effective operational business model as practised by POWERNET managing five networks in the southern South Island**

After receipt of the submissions Trustees hope that directors and management will engage with good faith in discussions with consumer groups to find resolutions to the issues that their customers are aggrieved with, the current system is creating genuine hardship and stress for many families.

Domestic consumers, businesses and Trustees are prepared to play their part in finding a way forward to more harmonious relationships between TLC and its consumer owners and an improved business model.