

14 February 2024

Tēnā koutou

## Using the “NZ EDB 2023 AMP Review” report within the DPP4 Reset

### Purpose of this letter

This letter provides context for the “NZ EDB 2023 AMP Review” report prepared by Innovative Assets Engineering (IAEngg) and its relevance for the DPP4 reset (the default price-quality path which applies to non-exempt electricity distribution businesses (EDBs) from 1 April 2025). It is intended to outline at a high-level some options for how findings from the report could be applied within the capex framework to inform discussion at the capex workshop and subsequent submissions.

The letter reflects preliminary thinking of Commission staff only. It does not reflect Commission positions or in any way prevent the Commission from taking different positions on the relevant matters. The options proposed should be read in conjunction with the other associated capex workshop material.

### Key messages

- The report has provided an opinion on the demand and expenditure forecasting practices outlined in EDBs Asset Management Plans (AMPs) and provides comfort that non-exempt EDBs’ capex forecasting approaches as explained in their AMPs broadly align with good industry practice.
- The report was not intended to verify expenditure forecasts contained within the 2023 AMP and therefore does not provide an opinion on whether expenditure forecasts are reasonable.
- We consider the report can be used to inform our capex forecasting approach but that use of individual assessments in the DPP4 capex framework may be challenging given changes in expenditure forecasts from 2023 to 2024 received in response to the s53ZD notice.

### Background and context for the IAEngg review

In 2023 we engaged IAEngg to review EDB’s AMPs, as we considered that an independent review of EDBs’ asset management practices and the robustness of their demand and expenditure forecasts would benefit our programme of EDB performance analysis and, in the case of non-exempt EDBs, the DPP4 reset as well.

The context for the review being undertaken by IAEngg was communicated to stakeholders in a stakeholder update letter issued 31 August 2023.<sup>1</sup>

### **Potential role of the IAEngg report to inform setting capex allowances**

In the DPP4 Issues Paper published on 2 November 2023 we explained how we intended to develop our capex forecasting framework.<sup>2</sup>

We noted that findings from the 2023 AMP review are likely to be an important consideration for how we develop and design the capex forecasting framework and how we use the information disclosed under the section 53ZD notice and the final 2024 AMP to set forecast capex for DPP4.<sup>3</sup>

We also noted that, in addition to the independent review of EDBs' AMPs, we intended to undertake our own high-level assessment of the reasonableness of the AMP capex forecasts.<sup>4</sup>

The Issues paper identified that for a number of EDBs the 2023 AMPs represented a large step change in forecast expenditure. To be able to rely on forecasts contained within the AMP, particularly where there are material step-changes in forecast expenditure and historical expenditure provides less guidance on what is appropriate, having confidence in the AMPs is critical. Engaging external expert support in undertaking our review of the AMPs was intended to inform our understanding of the basis on which EDB forecasts may be used to set the DPP.

IAEngg have reviewed information disclosed within the 2023 AMPs, with additional supporting information where requested. As was anticipated, a number of EDBs have forecast material changes in their 2024 expenditure forecasts disclosed in response to the section 53ZD notice compared to those included within the 2023 AMPs.

In addition to the potential use of the 2023 AMP review in our capex framework, we consider that there may be value in undertaking further detailed reviews of certain capex expenditure categories for some EDBs, particularly relating to material variances identified in 2024 forecasts, submitted in response to the s53ZD notice. The focus of these reviews will be informed by review of s53ZD information and feedback on the role of independent reviews and the findings from the 2023 AMP review.

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<sup>1</sup> Commerce Commission "[Stakeholder update on reviews of EDB 2023 AMPs and efficiency](#)" (31 August 2023).

<sup>2</sup> Commerce Commission "[Default price-quality paths for electricity distribution businesses from 1 April 2025 – Issues paper](#)" (2 November 2023), paragraph 3.17.

<sup>3</sup> On 10 November 2023, the Commission issued a section 53ZD notice to all Non-exempt EDBs requiring the disclosure of the most up to date forecast expenditure information (e.g., that contained in draft 2024 AMPs) alongside other information required to set DPP4. A copy of the notice is available here: [Commerce Commission - 2025 reset of the electricity default price-quality path \(comcom.govt.nz\)](#)

<sup>4</sup> Commerce Commission "[Default price-quality paths for electricity distribution businesses from 1 April 2025 – Issues paper](#)" (2 November 2023), paragraph 3.18.

### *Role of the AMP compared to an expenditure proposal*

We were not expecting the IAEngg review to verify AMP forecasts to be used in our capex framework, but to inform our capex forecasting approach including providing confidence in the approaches which EDBs take to supporting forecasts.

In the letter to stakeholders we noted that the DPP is intended to be a relatively low-cost regulatory tool, and we did not expect that the extent of analysis or level of assurance which would be provided by IAEngg would be at a similar level to ‘customised price-quality path’ proposals, which are supported by independent verification.

The requirements of an AMP are detailed within Attachment A of the Electricity Distribution Information Disclosure Determination 2012.<sup>5</sup> The requirements of a CPP proposal are in Part 5 of the input methodologies for customised-price quality paths, and capital and operating expenditure information requirements are contained in schedule D.<sup>6</sup>

As the name implies, the focus of an AMP is primarily on providing information to interested persons on asset management practices. The content and process requirements for a CPP proposal are aimed at supporting the Commission’s evaluation of a supplier’s expenditure proposal, including whether the proposed expenditure meets the expenditure objective.<sup>7</sup> While the AMP includes requirements related to demand and related expenditure forecasts these are comparatively limited compared to what would be contained within a CPP proposal. For example, a subset of the information requirements for a CPP proposal may be met by submitting an asset management plan as part of a CPP proposals.<sup>8</sup>

### **Submissions on the DPP4 issues paper**

We received a number of submissions on the DPP4 issues paper identifying stakeholder interest in seeing the outcome of the independent review, including the following statements:

“We note the commission is awaiting the findings from an independent review on the reasonableness of EDBs’ demand and expenditure forecasts for capital expenditure for 2025-2030. The Council looks forward to seeing the results of this review and to be able to comment in more detail.” – Consumer Advocacy Council<sup>9</sup>

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<sup>5</sup> Commerce Commission “[Electricity Distribution Information Disclosure Determination 2012](#)” (6 July 2023)

<sup>6</sup> Commerce Commission “[Electricity Distribution Services Input Methodologies \(IM Review 2023\) Amendment Determination 2023](#)” (13 December 2023).

<sup>7</sup> Expenditure objective means the objective that capex and opex reflect the efficient costs that a prudent non-exempt EDB would require to a) meet or manage the expected demand for electricity distribution services, at appropriate service standards, during the DPP regulatory period or CPP regulatory period and over the longer term; and (b) comply with applicable regulatory obligations associated with those electricity distribution services.

<sup>8</sup> Commerce Commission “[Electricity Distribution Services Input Methodologies \(IM Review 2023\) Amendment Determination 2023](#)” (13 December 2023), Attachment D.

<sup>9</sup> Consumer Advocacy Council “[Submission on: Default price-quality paths for electricity distribution businesses from 1 April 2025](#)” (18 December 2023), p. 3.

“It is unfortunate that the findings of this review were unavailable during this consultation period, but we look forward to engaging on the results through discussion at the capex forecasting framework workshop indicated for next year.” - Major Electricity Users' Group<sup>10</sup>

Some of the submissions received on the issues paper indicated high expectations of what the review may have been able to achieve in terms of providing comfort on EDBs expenditure forecasts, including the following statements:

“The independent reviews of AMP should provide the Commission with the comfort and confidence to only consider adjusting capex allowances for investments that are very uncertain.” – Wellington Electricity<sup>11</sup>

“Additionally, we endorse using Innovative Assets Engineering (IAEngg) to assess the reasonableness of EDBs' demand and expenditure forecasts. This approach helps ensure that approved expenditure allowances are underpinned by a robust rationale, instilling confidence among the Commission and other stakeholders that they are efficient and align with future needs.” - Powerco<sup>12</sup>

### **Initial staff views on the independent report**

We consider the review has generated informative insights for our performance and analysis function on the role and contents of AMPs.

The final IAEngg report provides overall comfort that non-exempt EDBs' capex forecasting approaches as explained in their AMPs broadly aligns with good industry practice. Where an EDB overall assessment is provided in the report, IAEngg rated the EDB's practices as either 'good' or 'average'. This overall comfort about the forecasting approaches described in the AMP may inform our view, for example, when choosing thresholds for applying further scrutiny to EDBs' forecasts within DPP4.

We consider the report can be used to inform our capex forecasting approach for DPP4 and have detailed the specific application which we see may be appropriate within our capex framework later in this letter.

### **Extent to which AMPs can support DPP forecasts**

An intended outcome of the 2023 AMP review was that IAEngg identify and analyse key drivers of change, uncertainties, and variables in financial and demand forecasts and provide an independent opinion on the reasonableness of the variations contained in EDBs 2023 AMPs.

The report provides IAEngg's opinion on whether the description of how demand forecasts are prepared and the approach for converting demand forecasts into expenditure is reasonable and how the practices described align with good electricity industry practice.

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<sup>10</sup> Major Electricity Users Group [“DPPs for EDBs from 1 April 2025 – Issues paper”](#) (19 December 2023), p 3.

<sup>11</sup> Wellington Electricity [“Submission to Default price-quality paths for electricity distribution businesses from 1 April 2025”](#) (19 December 2023), p. 14.

<sup>12</sup> Powerco [“Powerco's submission on EDB DPP4 issues paper”](#) (19 December 2023), p. 10.

IAEngg's opinion does not extend to quantitative analysis to determine whether the expenditure forecasts themselves are reasonable.

IAEngg have identified a number of constraints which limited its ability to assess demand and associated expenditure arising from the expenditure drivers for 2026-2030.<sup>13</sup>

IAEngg notes that demand drivers, particularly those arising from de-carbonisation and climate resilience, are subject to both quantity and timing uncertainties. Most of the drivers contain significant assumptions which materially impact forecast demand and hence expenditure e.g. EV uptake is very sensitive to government rebates, residential conversion rate from gas to electrical appliances is very sensitive to government policy and incentives, equipment costs and gas prices; process heat conversion may not result in all customers switching to electricity as there are other possible substitution energy sources such as wood pellets and biofuels.

In order to quantify demand drivers considerably more information would need to be assessed than is contained within the AMPs.

EDBs' AMPs do not include the models used by EDBs to forecast demand nor do they directly outline the relationship between inputs used in expenditure forecasts and the expenditure forecasts. Further, the AMPs do not present the inputs, in particular the new drivers, used to forecast demand or expenditure in a defined or consistent way.

IAEngg also noted complexity relating to inconsistencies in reporting practices, or between the ID requirements and business systems. Notably:

- The standardised expenditure categorisation for reporting expenditure forecasts in Schedule 11a "Capex forecast" and 11b "Opex forecast" assists in performing comparison between EDBs but may not be aligned to the categorisation used internally within the EDB businesses.
- EDBs use mapping tables to map internal categorisation to regulatory categorisation but there appears to be a degree of subjectivity and inconsistency in the mapping approach.
- A minority of EDBs are apportioning capex project costs into the different regulatory capex categories based on their purpose
- There are inconsistencies of how costs associated with LV visibility, future DSO functions and open access networks are categorised.

IAEngg have identified these constraints limited its ability to:

- Assess the reasonableness and accuracy of key inputs / drivers used in forecasting expenditure

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<sup>13</sup> IAEngg, "NZ EDB 2023 AMP Review: Forecasting and Planning Assessment Report" (29 January 2024), Section 5

- Specifically identify projects or programmes of work where there is significant uncertainty about the need for, or timing of, forecast expenditure
- Assess the sensitivity of the expenditure plans to out-turn differences in requirements

**The report provides an assessment of demand and expenditure forecasting practices**

Given the limitations identified above, in order to address the terms of reference for the review, IAEngg undertook a process that involved the following high-level steps:

- Identifying and describing good electricity industry practice in forecasting demand and expenditure
- Determining thresholds for analysis
- Assessing the certainty and reasonableness of the drivers identified by the EDB which has resulted in increased expenditure.
- Assessing the demand forecasting approach of each EDB
- Assessing the EDBs approach to convert demand into expenditure

Following this process IAEngg have, for all EDBs, created a snapshot of expenditure proposed for the 2026 – 2030 regulatory period and identified whether a standardised set of drivers have been included within the EDB’s AMP.

IAEngg have identified material variances in expenditure categories for selected EDBs, compared to its selected reference period.<sup>14</sup> For these expenditure categories IAEngg has, where possible:<sup>15</sup>

- Identified the underlying drivers and assessed their associated certainty<sup>16</sup> and reasonableness.
- Provided an assessment of the EDBs demand and expenditure forecasting practice against IAEngg’s good practice guidelines and assessed whether the accuracy is reasonable.

The report provides findings related to material variances in opex expenditure categories, in particular identifying drivers and insights for more material variances from historic averages,

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<sup>14</sup> IAEngg’s identification of material variances is based on its professional judgement for the purposes of its report, and these are not materiality thresholds determined by the Commission provided to IAEngg for application.

<sup>15</sup> The report identifies where insufficient information was contained within the AMP, or where relevant, obtained from the EDB in meetings to enable IAEngg to provide its opinion.

<sup>16</sup> Definition of ratings for assessing certainty are included within Table 1 of the report, IAEngg, "NZ EDB 2023 AMP Review: Forecasting and Planning Assessment Report" (29 January 2024), p 24.

these are detailed within Chapter 4 and Appendix A. These will be considered as part of our opex forecasting programme within DPP4.

IAEngg noted that they were not able to provide detailed expenditure category assessments for opex, identifying that:

EDBs have only offered qualitative reasons for forecast opex increases in their AMPs. This approach does not provide sufficient granularity for assessment of the (economic) justification, validity of the cost drivers and departures from historical trends. It is also not clear whether the forecast has considered the potential offset from productivity improvement and scale efficiency improvements.<sup>17</sup>

### **Application of findings of the review within the capex framework**

As outlined within section 4.3 of the report the review has focussed on material variances in expenditure categories for 2026-2030 compared to average expenditure over 2021-2023.

This means that for most EDBs only some expenditure categories have been selected for further analysis, with some EDBs not having any expenditure categories exceeding the materiality threshold and accordingly not having more in-depth scrutiny to understand demand and expenditure drivers. Of the material expenditure categories selected not all underlying drivers were subject to review, with IAEngg focussing on the key drivers for those expenditure categories.

We also note that information on capex expenditure submitted in response to the s53ZD notice has indicated significant changes in forecasted expenditure for some EDBs, compared with the 2023 AMPs. Some of the expenditure categories representing material variances were reviewed as part of the 2023 AMP review process, but others were not.

Therefore any application of the findings of the report within the capex framework needs to consider whether the information exists to be consistently applied across EDBs, or implementation would require further assessment by IAEngg.

### *Overall ratings for EDBs and view of key drivers*

For the majority of EDBs, IAEngg were able to find information about their demand forecasting approach and assigned qualitative ratings (excellent, good, average, needs improvement) based on good industry practice. EDB ratings were found to be either “good” or “average”.

Our current view is that this overall view of practice and key drivers for forecast step change in capex may be a consideration for how thresholds are set within the capex framework.<sup>18</sup> We consider the report can be used to inform our capex forecasting approach, and any

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<sup>17</sup> IAEngg, "NZ EDB 2023 AMP Review: Forecasting and Planning Assessment Report" (29 January 2024), p.91

<sup>18</sup> IAEngg have established a materiality threshold for undertaking further analysis for the purposes of its report. Within the DPP4 reset capex framework the term threshold refers to certain numerical boundaries based on metrics related to specific capex categories. They are intended to provide a low-cost way of identifying forecasts that require additional scrutiny to see if they can be accommodated within the capex allowance. Within the DPP4 reset thresholds may be set at an aggregate or category level.

related application of thresholds in aggregate. However, the use of individual assessments within the DPP4 capex framework may be challenging given changes in expenditure forecasts from 2023 to 2024 received in response to the s53ZD notice means the assessment will not necessarily be available for all categories where there are material variations in expenditure forecasted.

### *Growth Drivers*

The report assesses “certainty” and “reasonableness” of growth drivers for expenditure categories. Where particular expenditure drivers are assessed as more certain for all or a majority of EDBs the capex framework could theoretically account for this by setting a higher threshold for this type of expenditure. However, we note there are multiple drivers within an expenditure category, and we don’t necessarily have weightings of the driver’s contribution to the change in the expenditure forecast.

To address this the certainty and reasonableness of expenditure drivers could also be assessed against the most up to date capex forecast provided in response to the s53ZD notices, which required projects and initiatives be grouped by the primary driver of expenditure. We note that the application of this may be applied in aggregate rather than for individual EDBs as there is inconsistency between the expenditure categories which were analysed as part of the 2023 AMP review and those which met the materiality threshold for further information to be provided under the s53ZD notice. Application of this approach may require further information be obtained from EDBs in order to apply the framework consistently.

### *Other standardised assessments contained within the IAEngg report*

The template employed by IAEngg for assessing material expenditure category changes also includes assessment of particular trigger points, dependencies and risks, assumptions and sensitivities for each expenditure category subject to more in-depth review.

Whilst useful contextual information these fields are relatively inconsistently populated based upon the extent of information which may have been contained within the AMP. Accordingly, these may provide relevant additional information to support material expenditure variances for individual EDBs, but the information is unlikely to be able to be applied for standardised assessments across the capex framework.

### *Other contextual information contained within the IAEngg report*

The report provides other contextual information which we will consider in our assessment of capex allowances, particularly within the findings section of the report (Section 4). As these findings are generally more qualitative than quantitative, they may be used to provide context for particular expenditure increases.

### **Potential further review of forecasts (including information provided under s53ZD notice issued 10 November)**

We consider that there may be value in undertaking further detailed reviews of certain capex expenditure categories for some EDBs, particularly relating to material variances identified in 2024 forecasts, submitted in response to the s53ZD notice.

We note that, for material variances, the s53ZD notice required EDBs to provide information which supported the forecast capital expenditure and identify a primary driver for each project and initiative and sum the total cost and demand for that driver. The structure of this request followed engagement with IAEngg on additional information which would be useful to support demand and expenditure forecasts. Noting we did not request as part of the s53ZD the underlying data and assumptions which made up the 2024 forecasts and accordingly there will still be limitations to the review which can be undertaken.

The scope of any further review, were this to be undertaken, would be informed by further development of the capex framework, discussions at the capex workshop and associated submissions.

Any further information gathering would be tailored and targeted at specific expenditure where we consider the provision of further information would inform the application of our DPP4 capex framework.

**Process for expressing views on how the “NZ EDB 2023 AMP Review” report may be utilised within the DPP4**

We have appreciated engagement to date by EDBs with IAEngg which assisted in the production of the report.

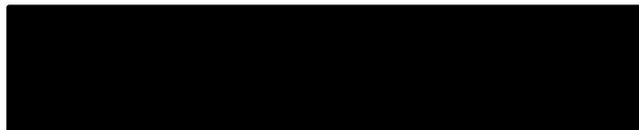
We are interested to understand from stakeholders how they consider the findings in the “NZ EDB 2023 AMP Review” report may be able to be utilised within our assessment of expenditure allowances.

Stakeholders will be able to provide feedback on this as part of the capex workshop and as part of the submission process that will follow this. Further information regarding the process for submission will be outlined within the capex workshop materials.

If you have any queries on this letter, please contact:

Simon Wakefield, Principal Adviser, Price Quality Regulation at [infrastructure.regulation@comcom.govt.nz](mailto:infrastructure.regulation@comcom.govt.nz) including ‘2023 AMP review application to DPP4’ in the subject line of your email.

Ngā mihi nui



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