



29 August 2014

John McLaren
Chief Advisor
Regulation Branch
Commerce Commission
via email: regulation.branch@comcom.govt.nz

Dear John

Proposed Default Price-Quality Paths for Electricity Distributors from 1 April 2015

This is a cross-submission by Contact Energy Limited (**Contact**) on the Commission's two consultation papers dated 4 July 2014 (**Papers**):

1. Proposed Default Price-Quality Paths for Electricity Distributors from 1 April 2015 (**DPP Paper**); and
2. Low cost forecasting approaches for Default Price-Quality Paths 2015 (**LC Paper**)

In this submission we have focused on the specific areas where we believe our comments can add value.

Treatment of compensation for shortfall in revenue

On Page X5 of the DPP Paper the Commission seeks feedback on the period over which the deferred claw-back should be applied i.e. over 1 or 2 regulatory periods. We recommend the use of 2 regulatory periods for the reason highlighted in the DPP Paper, that minimising price shocks to consumers should be a significant consideration in making this decision.

Allowances for pass through and recoverable costs

In footnote 40 of the DPP Paper the Commission invites views on the materiality of the issue raised by Genesis in a submission to the Commission: that the ability for EDB's to recover pass-through costs and the allowed recoverable costs in full removes any incentive for the distributor to test the costs are justified.

Contact has submitted in support of Vector's proposal on how to improve compliance requirements as they relate to pass-through and recoverable costs. However the ability to pass-through costs should not absolve the EDBs of the ability to seek to influence the magnitude of those costs. If incentives can be introduced to achieve this the outcome would be better for consumers. Contact agrees with comments made by MEUG on this issue in their submission on the DPP Paper (**MEUG Submission**).

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Benchmarking

Consistent with views expressed by Contact to the Commission in submissions over the last few years we suggest that the Commission ask the Government to review the prohibition contained in section 53P(10) of the Commerce Act. This section prohibits the Commission from using comparative benchmarking on efficiency in order to set starting prices, rates of change, quality standards, or incentives to improve quality of supply. To this end we agree with the comment made in the MEUG Submission that the prohibition on benchmarking is likely to lead to inferior outcomes in terms of the long-term benefit of consumers.

Low Cost Load Forecasting

Contact does not believe the Commission's position set out in the LC Paper is supported by recent trends and insights. As an Appendix to this letter we have included comments that we are hopeful will inform the Commission's approach. We are happy to further discuss this matter with the Commission.

Please do not hesitate to contact us if you have any questions.

Yours sincerely



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Response to Low Cost Forecasting and Submissions

As a vertically integrated generator-retailer, with a nationwide retail business, Contact has a whole of market view informed by a 22 per cent share of residential electricity customers and one quarter of non-residential load (excluding Tiwai). We lack the detailed regional view of distribution companies.

National demand for electricity has stalled, with 0.1% pa average growth 2006 – 2013. This flattening is partly due to several key one-off events like Tiwai transformer failure (November 2008), Christchurch Earthquakes (2010-11) and the impact of the Global Financial Crisis (2008-09). It is however increasingly accepted that key underlying drivers are increasing residential efficiency, and declining non-residential energy intensity - driven by both efficiency gains and a structural shift away from manufacturing towards professional services.

Load forecasting used for regulatory purposes should address the clear recent trends of declining residential usage and reduced energy intensity of non-residential demand. Market participants are increasingly aware of these factors and seeking to understand their impact on the industry and their businesses.

The Commission sought feedback on the proposition that “electricity consumption by the average residential user is unlikely to fall over the next 5-7 years”. We do not think this position is supported by recent trends and insights gained.

In line with other submissions including Vector, and Castalia, ENA and Sapere, we recommend the Commission re-evaluates the proposed forecasting methods for both Residential, and Commercial and Industrial consumers.

We comment specifically on the following sections:

(a) Summary statistics revenue growth (paras 2.37 – 2.40)

The regulated EDBs listed in Table 2.10 include about 75% of national ICPs. Assuming constant price revenue is proportional to demand, the weighted average implied demand growth is 1.13% pa from 2015 – 2020. With forecast growth in households for this period 1.16% pa, this implies a change in total (residential and non-residential) national demand per household of -0.03% pa.

This reduction in underlying demand does not seem large enough given recent trends (the 3-yr average annual change in total demand per household has fallen from 1.6% pa in 1990 to 0.5% pa in 2000, to -0.7%

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pa in 2010 and was -2.2% in 2013). As below, these point to both ongoing residential efficiencies and decreasing non-residential energy intensity which we don't see reversing in the near future.

(b) Revenue Growth for Residential consumers (paras 5.12 – 5.20):

The Commission's approach is to equate regional ICP growth rates with forecast population growth by region, and to assume constant residential usage per ICP. We agree with other submissions on the LC Paper that the direct ICP – population link should be re-considered against available data on forecast of household numbers, and also with regard to changing household occupancy.

From our views on the underlying drivers of residential usage, the assumption of constant residential usage (on an ICP or household basis) until 2020 is not supported by recent trends and underlying drivers which on balance point to declining usage. Average domestic usage per household in New Zealand has been easing over the last 25 years, with an accelerated reduction apparent in the last 4 years

(c) Revenue Growth for Commercial and Industrial consumers (5.21 – 5.25):

The Commission proposes that constant price revenue for C&I consumers is calculated from regional GDP forecasts and a universal GDP elasticity of energy of 0.73 (i.e. a 1% growth in GDP gives rise to a 0.73% rise in C&I energy consumption).

We lack complete C&I sales data at a regional level, but at a national level we find this elasticity parameter to be too high leading to an over-estimate of C&I load growth relative to forecast GDP. Our national level analysis below suggests this elasticity factor has steadily fallen to a current value of about 0.4. Given an average national elasticity factor of 0.61 between 1994 and 2013, the assumption of a strong turn-around in the reported decline in energy intensity would be required to support the forecast energy intensity of 0.73.

The simple trend approach used by Castalia for residential load could be adapted for C&I load: use available time series data on sector GDP and sector energy intensity and extrapolate these trends; regional C&I load growth could be calculated by a regional weighting of sectors. Alternatively, regional GDP forecasts from NZIER could be coupled directly with regional trends in energy intensity.

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