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4 May 2012

Dr Mark Berry  
Chair  
Commerce Commission  
Po Box 2351  
Wellington

Dear Mark

### **Notice to supply revenue information**

We refer to your letter of 18 April 2012 requiring us to supply revenue information under section 53ZD of the Commerce Act 1986.

The spreadsheet containing the information has been emailed to the Commission along with a copy of this letter. The spreadsheet includes various caveats and comments on the data provided.

However, we have additional comments on and concerns with the process and nature of the request that cannot readily be accommodated in the spreadsheet. These are set out below. Note that these comments and concerns are all aside from the fact that any assessment of the current and future profitability of Orion, for whatever purpose, cannot reasonably ignore the effects of the earthquakes.

We note that some of this ground may have been covered last year in discussions about the starting price adjustment process, but for reasons the Commission will be well aware of, Orion could not be fully engaged with that process.

### **No clear purpose**

Our main concern is that there is no clear purpose for the request. We understand that it may have been driven by a suggestion from Unison or the ENA of alternative ways of analysing quantity growth. This suggestion was we believe caveated with comments that not all distributors would be able to provide information in the same way, and that there should be discussion about the idea before the information was sought.

We consider that it would indeed have been better to first seek our comments on the proposed approach rather than to simply request data in relation to it.

To the extent that we understand the proposed approach we have the following comments:

- Distributors' chargeable quantities (be they energy volumes, connection numbers, peak demands or whatever) will almost certainly be linked to developments in the external environment (such as population growth, economic growth, energy efficiency and technology change to name a few).



- To the extent that the external factors can be measured, a relationship between them and the chargeable quantities can certainly be estimated, but that does not mean that the relationship is *directly* proportional. For example even if population growth is the sole and direct driver of fixed revenue growth, and population growth can itself be exactly predicted, that does not make projections of population growth an applicable factor unless the relationship itself is known. It cannot reasonably be assumed to be 1 to 1.
- If such a relationship can be properly established – for example using regression analysis – then there is no need to segment distributors' chargeable quantities: the Commission only need to acquire historical movements in chargeable quantities (appropriately weighted) as the dependent variable and regress these against the independent variables. The relationships (and their statistical properties) will emerge as the coefficients and standard errors of the regression analysis.
- Alternatively, particularly given the uncertainty of forecasts of the independent variables, the Commission could rely simply on the trends in the chargeable quantities themselves<sup>1</sup>, which is how Orion (at least in a non-earthquake environment) goes about conducting its quantity forecasting. We also include for your information our own projections of chargeable quantities for the 2012/13 year that were used in our recent pricing updates for that year, together with graphs for the two most significant quantities.
- Pricing structure changes, such as those implemented by Orion from 1 April 2009, can make the use of actual historical quantity data problematic for forecasting. *Estimates* of historical volumes on the *new* basis are inevitable in this case, but these could easily have a different relationship with external factors than did the no longer relevant actual.

### **Inability of systems to provide data**

The request seems to have proceeded on the basis that the requested information is readily available. In Orion's case this is not so:

- We do not use the categories assumed by the request. While the Commission acknowledges in its letter that the customer groups are not "tightly define[d]", the extent of combining we have had to do to complete the spreadsheet is very significant, and effectively makes the categories meaningless in terms of applying different growth drivers.
- We have also had to recreate estimates of billed revenue, as neither our financial nor billing systems record and/or allow ready access to the details of our revenue and associated quantities as required. We have thus had to spend additional time explaining the difference between these estimates and our disclosed total revenue.
- Because the February 2011 earthquake had a dramatic effect on the quantities for the last five weeks of 2010/11 financial year, our recreated estimates are particularly overstated for that year (and of course projections based on pretty much any pre-quake historical information will be wildly inaccurate as the basis of projections for the following years.)

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<sup>1</sup> The auto-regressive approach to time-series analysis and forecasting is very well established.

**Timing**

We appreciate that your letter has two deadlines, and that the latter deadline of 4 May is more reasonable than the earlier one of 30 April, however it is still a very short timeframe, particularly given that we were not expecting to receive the request. We have done as well as we can in the very limited time available. Leaving aside whether the requested data is useful, we do not think the time given to provide it was reasonable. However, there simply is not a robust way for us to provide the data as envisaged, and more time will not solve that problem.

We would be very happy to discuss our comments and concerns with you at your convenience. Please contact myself or Dennis Jones in relation to this.

Yours sincerely

A handwritten signature in blue ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

David Freeman-Greene

**GM Commercial**