

**Submission on the Commerce Commission's  
Initial Observations on Forecasts Disclosed  
by 29 Electricity Distributors  
in March 2013**

From the Electricity Networks Association

23 December 2013

## Electricity distribution businesses supporting this submission

The electricity distribution businesses listed below support this submission.

Alpine Energy Ltd  
Aurora Energy Ltd  
Buller Electricity Ltd  
Centralines Ltd  
Counties Power Ltd  
Eastland Network Ltd  
Electra Ltd  
EA Networks Ltd  
Electricity Invercargill Ltd  
Horizon Energy Distribution Ltd  
Mainpower NZ Ltd  
Marlborough Lines Ltd  
Nelson Electricity Ltd  
Network Tasman Ltd  
Network Waitaki Ltd  
Northpower Ltd  
Orion New Zealand Ltd  
OtagoNet Joint Venture  
Powerco Ltd  
Scanpower Ltd  
The Lines Company Ltd  
The Power Company Ltd  
Top Energy Ltd  
Unison Networks Ltd  
Vector Ltd  
Waipa Networks Ltd  
WEL Networks Ltd  
Wellington Electricity Lines Ltd  
Westpower Ltd.

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## 1. Introduction

1. The Electricity Networks Association (ENA) appreciates the opportunity to submit on the Commerce Commission's (Commission's) Initial observations on forecasts disclosed by 29 electricity distributors in March 2013, dated 29 November 2013 (the Initial Observations Paper).
2. The ENA's contact person for this submission is:

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## 2. Initial observations

3. The Initial Observations Paper represents a further step in the Commission's development of its approach to summary and analysis of asset management information. The Commission is obliged to undertake summary and analysis of information disclosed in accordance with its Information Disclosure Determination (IDD),<sup>1</sup> as provided for in section 53B of Part 4 of the Commerce Act, 1986.
4. The Paper also touches on approaches for forecasting opex and capex, for the purpose of resetting the price path for those electricity network businesses (ENBs) subject to the Default Price-Quality Path (DPP).

### Consultation

5. We note that the Initial Observations Paper provides a relatively short (three week) consultation period. Accordingly our submission presents our initial thoughts on the Paper as it has not been possible to fully engage with our members on the topics addressed in the Paper within the consultation period.
6. We understand that there will be further opportunity in 2014 to comment on the topics addressed in the Paper, as the method for resetting the DPP price path is developed, and as further summary and analysis is developed for disclosure information.
7. In addition, the ENA has established a working group to examine possible approaches to forecasting opex and capex for the DPP. This working group is currently considering similar issues to those raised in the Initial Observations Paper. Accordingly the ENA anticipates providing further comments which are of relevance to the Initial Observations Paper, once the working group reports back in the new year.
8. We note that the Commission's workshop on the Initial Observations Paper was well attended, and ENA members appreciated the opportunity to discuss the Paper in this forum. The ENA continues to support the use of workshops during the Commission's consultation processes, where appropriate.
9. We note that the Commission's stakeholder survey indicates that most respondents feel they have a good understanding of electricity sector

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<sup>1</sup> Commerce Commission, *Electricity Distribution Information Disclosure Determination 2012*, 1 October 2012

company performance. It would be useful to understand how the Commission has factored this result into its planned approach to summary and analysis of disclosure information.

10. We also refer to the Commission's 2011 consultation on ENB opex and capex.<sup>2</sup> This preliminary consultation considered some of the same issues which are now presented in the Initial Observations Paper. The consultation on the development of the IDD during 2011 and 2012 also touched on similar issues.
11. We note that the views expressed during these previous consultations are largely absent from the Initial Observations Paper. Accordingly, it is not clear to our members how the Commission has analysed earlier submissions and whether it has adequately considered and responded to the suggestions and comments raised in them.

## **Approach to summary and analysis**

12. The Initial Observations Paper is consistent with the suggestions put forward by the Commission in the 2011 consultations noted above, including the topics that the Commission specified for its information disclosure (ID) technical workshops.
13. We conclude that the Commission has had a clear view on how it intended to approach its summary and analysis role in respect of asset management information, for some time. However we suggest that this has not been well articulated to ENBs to date. We do not believe that there has yet been a robust debate with interested parties about alternative approaches to the summary and analysis role. For example, the Initial Observations Paper does not provide information about alternative approaches that could be adopted.
14. We acknowledge that capex and opex models are relevant to setting the DPP price path. However it does not necessarily follow that similar models are also required for ID summary and analysis. We suggest that this issue requires further consideration, including more comprehensive debate as to other approaches which could be adopted for ID and what the Commission is seeking to achieve overall with such modelling.
15. It appears that the Commission is seeking to explain the expenditure profiles of EDBs by reference to particular expenditure drivers. Presumably this is to

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<sup>2</sup> Commerce Commission, *Information Disclosure: Approaches for Understanding EDB and GPB Cost Efficiency, Technical Paper for Consultation*, 7 October 2011

assist interested users understand why different distributors have different forecast expenditure profiles. While the ENA supports initiatives to improve consumers' understanding of EDBs' expenditure requirements, we are concerned about the extent to which high level models will be capable of explaining expenditure requirements over time. We are particularly concerned that models that explain variations in capex and opex across the sector will be used for developing time-series forecasts without testing that such models are fit for such purposes.

### **3. Data summaries**

16. The Initial Observations Paper usefully collates the template information included in the Asset Management Plans (AMPs) disclosed by ENBs in March 2013. These templates were introduced in the IDD. The 2013 AMPs contained the first set of disclosures consistent with the IDD.
17. The information contained in the Initial Observations Paper highlights:
  - the wide variance in forecast vs historical data across ENBs
  - that many ENBs are forecasting significant increases in opex and/or capex
  - that some ENBs are forecasting notable decreases in opex and/or capex
  - the introduction of the IDD has resulted in some step changes in the data time series, particularly from FY13 onwards
  - that there may be initial interpretation or categorisation issues and/or inaccuracies which compromise the observations
  - that there are significant variances for a large number of ENBs between modelled opex (using the DPP model) and AMP forecasts.
18. However, the Initial Observations Paper and the accompanying database provide a useful perspective to the industry of ENB opex and capex, and an opportunity for further consideration and analysis.

### **4. Opex and capex models**

19. The Initial Observations Paper includes discussion about possible models that could be developed to seek to explain variation across ENBs' capex and opex forecasts.

## Price path models

20. We acknowledge the intent for such models in a price setting context (ie: for the purpose of informing the DPP price path with reference to current and projected profitability).
21. We note that high-level models will never be able to fully explain the range of factors which influence an ENB's expenditure plan. In our presentation at the workshop we noted the following factors which influence asset management decisions, which we believe are likely to be difficult to account for in models:
  - risk appetite
  - organisational capability and resources (including data and knowledge)
  - future expectations
  - customer preferences
  - attitudes to technology and innovation
  - changes in regulation and legislation.
22. Any summary will need to recognise that there are significant differences between ENBs, ranging from differences in geographic area covered, customer density, age of assets, network design, climate, customer expectation and acceptance of outages, customer willingness to pay for undergrounding, etc. In principle all of the above factors should be normalised before any meaningful comparative judgements can be made. We suggest that this is not possible.
23. The difficulty of properly correcting for the different circumstances of ENBs and the substantial informational needs required for such an exercise, was a key reason that the restriction on comparative benchmarking on efficiency in order to set DPP starting prices, rates of change, quality standards, or incentives to improve quality of supply was inserted into the Commerce Amendment Bill.
24. In addition, we note that inevitably capex and opex requirements will be affected by externalities. Currently ENBs are facing pressures to strike a new balance between risk exposures and network augmentation reflecting, in particular, the Commission's views on insurance cover that have emerged from Orion's CPP application. In parallel, ENBs are facing additional liability exposures arising from the enactment of the Consumer Law Reform Bill, and these will also need to be factored into forward cost projections.



25. Looking forward, it is becoming increasingly likely that ENBs will assume some responsibilities for maintaining so-called service lines on private land, although this is a matter still under consideration.
26. Forecasting processes will need to acknowledge new and potential factors of this type that could have a material impact on capex and opex.
27. We also note that a number of ENBs are forecasting a step up, above historical levels, for asset replacement expenditure.<sup>3</sup> This is an issue which has been on the horizon for sometime as an increasing proportion of assets are approaching end of life.
28. To date a number of ENBs have been able to successfully defer the anticipated increase in renewals expenditure. End of life replacement must inevitably be addressed however, as assets cannot be maintained indefinitely. This will be a challenge for expenditure models, and will require consideration of asset health related drivers as well as organisational capacity to manage the programme.
29. As stated above, our working group is currently considering these issues in the context of the 2015 DPP reset and intends to provide further thoughts to the Commission on this topic in the new year.

## **Information disclosure models**

30. The IDD requires AMPs to include detailed opex and capex forecasts and supporting explanatory information, including asset quantity, age and condition data, and demand forecasts. Some of this information is identified as potentially being used for capex and opex models, possibly for the DPP price path reset. However the Initial Observations Paper infers that similar models could also be used by the Commission in fulfilling the summary and analysis requirement of ID regulation.
31. It is not clear why it is necessary for the Commission to prepare alternative forecasts of capex and opex than those prepared by the ENBs themselves, for this purpose. As noted previously, models will not be able to be developed to fully incorporate all factors which influence ENB expenditure. This raises the question as to how the hypothetical opex and capex forecasts generated by such models will be used, or what is to be inferred when the models are unable to successfully predict expenditure requirements?

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<sup>3</sup> This is mainly categorised as capex, but some asset renewals expenditure may also be categorised as opex.

32. It may be more appropriate for summary and analysis to focus on broad correlations between expenditure drivers and EDBs' expenditure forecasts, rather than undertake increasingly complex modelling that seeks to explain all expenditure requirements.
33. The Initial Observations Paper states at paragraph X18:

*We also provide the results of our modelling for operating expenditure, which partially explains the variation in the forecasts. In some cases, a more detailed understanding of a distributor's forecast is likely to be appropriate. In such cases, the distributor's Asset Management Plan provides additional information.*
34. The ENA considers that ENB AMPs should remain the primary source of information about capex and opex plans. These plans incorporate bottom up forecasting approaches, which take into consideration the information, knowledge and understanding that each ENB has about its network and its customers. This cannot be replicated in the top down models which are proposed.
35. Workshop attendees raised the possibility of reputational risks arising from unexplained variances between the Commission's models and ENBs' own forecasts. We encourage the Commission to consider incorporating ENB input into its summary and analysis process to assist to manage this risk.

## 5. Concluding remarks

36. The ENA appreciates the opportunity to provide our initial comments on the Initial Observations Paper. We note that due to the relatively short consultation period, we have not fully consulted with our members on the more detailed questions posed in the Paper.
37. We understand there will be further opportunities in 2014 to provide input into capex and opex models for DPP price setting purposes, and our forecasting working group is currently considering options in this respect.
38. We also understand that the Commission intends consulting further on its summary and analysis of ID information and we look forward to contributing to that consultation in 2014.
39. We would be happy to discuss the points raised in this submission with the Commission, if required.