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15 November 2022

Dear stakeholder

Request for feedback – Expenditure forecasting by electricity distribution businesses and areas of focus for the 2025 default price-quality path reset

Purpose of this letter

The purpose of this letter is to table a series of questions related to expenditure forecasting undertaken by electricity distribution businesses (EDBs) which we would like you to answer. Responses to these questions will increase our understanding of how asset management plans (AMPs) can support our expenditure forecasts for the EDB default price-quality path (DPP) to apply from 1 April 2025 (DPP4), our programme of performance analysis, and potential changes to our information disclosure requirements.

This request for feedback follows the discussion on expenditure forecasting at our "Forecasting and incentivising efficient expenditure for EDBs" workshop held on 7 November 2022.[1]

This letter also provides an opportunity to provide your views on emerging issues we should prioritise in our early-stage planning for DPP4.[2]

Ensuring our regulation under Part 4 remains fit for purpose

The energy sector is in a period of change and uncertainty, and the pace of change may accelerate. Where and when investment may be required will depend on a number of factors, including how government policy, consumer demand, and the market evolve. At the same time as electricity demand is expected to increase, there are new technologies and alternative solutions for accommodating growth on electricity networks.

Given that context, we consider early engagement on establishing robust expenditure forecasts will benefit the DPP4 reset process, our programme of performance analysis, and

[1] Information related to the "Forecasting and incentivising efficient expenditure for EDBs" workshop held on 7 November 2022 is available here

[2] For those less familiar with our approach to EDB DPP regulation there are some useful presentations available on our website, under the price-quality path tab, which were delivered during the DPP3 reset process available here in particular under the 5 November 2018, 27 February 2019 and 8 March 2019 tabs

our understanding of potential changes which could be made under our Targeted Information Disclosure Review – Tranche 2 work programme.

Specific areas of feedback which we are requesting

In submissions on the Part 4 Input Methodologies Review Process & Issues paper, some submitters contended that historical expenditure should not necessarily form the basis for required future expenditure.[3]

At a high-level there are two options for expenditure forecasting for DPP4:

1. We rely on an EDB's own forecasts because we have sufficient confidence in them, and the supporting evidence in the AMPs and from stakeholder engagement, potentially supplemented with additional information; or

2. We come up with our own forecasting methodology. For a DPP this is likely to involve generic, regional and business-specific inputs.

We may use different approaches for different EDBs, and different approaches for different categories of spend for the same EDB.

We will need to have sufficient confidence in the robustness of EDB forecasts to be able to use them for the DPP reset, recognising that EDBs might have an incentive to inflate costs and variations in quality and content of AMPs and in planning assumptions may mean it is not relatively low-cost to undertake detailed scrutiny of AMPs.

We would like you to answer a series of questions outlined within Attachment A. We raised these questions during our workshop, and this helped facilitate a useful conversation on expenditure forecasting challenges. Initial thoughts were provided to some of the questions, and we thank all those who spoke. Attachment A also includes the rationale for why we are asking each question and additional questions which may help frame stakeholder feedback.

We are also providing an opportunity for stakeholders to raise other issues they consider we should consider in our planning for DPP4.

You should note that, as part of our IM Review process, we are simultaneously considering other parts of the regulatory regime which could impact on our approach to the DPP4 reset, including affecting how expenditure forecasts are used.

This could include a revised approach to incentives and/or classifying certain types of expenditure as being pass-through or recoverable costs or being subject to different incentive rates. These topics were also discussed in the workshop as well as the role and application of in-period adjustment mechanisms with separate engagement on these topics being undertaken outside of this process.

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3 For example, Electricity Networks Association "Part 4 Input Methodologies Review" p. 15 and Orion Group "Feedback on the Input Methodologies 'Draft Framework Review' and 'Process and Issues' Papers", p.37.

Interaction with Asset Management Plan disclosures

We look forward to reviewing EDBs' 2023 – 2033 AMPs, which should provide significant amounts of supporting information for EDBs' expenditure forecasting. We recognise that several of the questions contained within Attachment A seek feedback on topics that might be covered as part of information required in the AMPs that EDBs will be currently preparing.[4]

We are seeking feedback in advance of the 2023 AMPs as we are looking to be better informed on some key challenges facing EDBs and better understand the extent to which the AMPs will reflect the scale of expenditure uplift indicated in some submissions.

While this request for feedback includes specific questions, we are open to other feedback which will increase our understanding of how AMPs can support expenditure forecasting for DPP4, our programme of performance analysis, and information disclosure requirements.

The questions are framed as requesting specifics of forecasting practices. Accordingly, these are most directly targeted at EDBs themselves and supporting industry associations. However, we welcome wider stakeholder views with regards to EDB expenditure forecasting.

Providing your feedback

We welcome all feedback on this letter by 5pm on 16 December 2022. Responses should be addressed to:

Ben Woodham, Electricity Distribution Manager;
c/o infrastructure.regulation@comcom.govt.nz;
'EDB Expenditure forecasting' in the subject line of your email.

We intend to publish feedback we receive unless there is a clear and explicit request to not publish it due to confidentiality or commercial sensitivity. We will consider any such requests on their merits.

We request feedback be targeted to considerations for DPP4, our programme of performance analysis, and our information disclosure requirements.

[4] Refer Attachment A of the Electricity Distribution Information Disclosure Determination 2012 (consolidated December 2021) available here

We acknowledge that there are other parts of the regulatory regime which relate to expenditure forecasting which are being considered as part of the IM review, including, but not limited to, in-period adjustment mechanisms and strength of expenditure incentives. Issues which relate to our 2023 IM Review are better considered within the specific processes related to that review, as outlined here.

Yours sincerely

Andy Burgess
General Manager,
Infrastructure Regulation

Attachment A: Specific areas of feedback we are requesting

<table>
<tr><th>Area</th><th>Confidence in forecast requirements</th></tr>
<tr><td>Primary question</td><td>How are EDBs obtaining confidence in establishing the requirements they are forecasting to meet, including but not limited to demand, resilience, and reliability?</td></tr>
<tr><td>Additional questions to help frame responses</td><td>i. Are EDBs intending to change the inputs used in forecasting expenditure given key drivers of forecasts may have changed – particularly in the following areas:

• Connection growth (e.g., new connections from development, green fields and brown fields)
• Large capacity growth, (e.g., decarbonisation, industrial growth)
• Incremental demand growth (e.g., EVs, residential technology)
• Legislative change

ii. With a potentially increased need for resilience-related investment, what are the key inputs for EDB resilience forecasting?

iii. What forms of assurance will EDBs use (e.g., external verification) to provide confidence in forecasts, particularly where new forecasting inputs are used?</td></tr>
<tr><td>Why we are asking this question (Relation to regime)</td><td>DPP reset
• We better understand what forms of assurance may be available to support EDB forecasts
• We have improved visibility on categories of expenditure where we may be able to obtain confidence in EDBs' approaches in a relatively low-cost manner
• We are better informed on potential forecasting inputs we could use

Performance Analysis
• We are better informed of where our summary & analysis work may assist EDB practice</td></tr>
</table>

Area	Step changes and scenarios
Primary question	Are there specific events or metrics that can be forecast and then observed that indicate that a step change in expenditure is required or an alternate scenario is playing out?
Additional questions to help frame responses	i. What forms of information do EDBs use to build scenarios on the different forecast areas? ii. What are the underlying drivers where EDBs are forecasting a potential significant step change in expenditure requirements compared to previous levels? iii. Are there trigger points where increased certainty on level of spend required may be obtained? iv. What are the key dependencies or risks EDBs have identified which may impact forecast scenarios? v. Do EDBs consider that the expenditure required to address different scenarios may usefully follow proxies or will these be disjointed and network characteristic and network design specific increases? vi. What is the sensitivity of the expenditure plan to out-turn differences in requirements like incremental demand growth, resilience, decarbonisation, and connection growth?
Why we are asking this question (Relation to regime)	*DPP reset* • We are better informed on potential forecasting inputs we could use • We have improved visibility on categories of expenditure where EDBs have higher and lower levels of confidence in the robustness of their forecasting *Performance Analysis* • We are better informed of where our summary & analysis work may provide insights on potential step changes or alternate scenarios

Area	Confidence in expenditure plan
Primary question	How are EDBs obtaining confidence that their proposed expenditure plan is the most effective and efficient solution for the forecast level of demand, resilience requirements, and reliability levels?
Additional questions to help frame responses	i. In which categories of expenditure do EDBs have greater levels of confidence than others? ii. Where new sources of uncertainty exist related to potential increases in expenditure requirements, is there a particular driver of the uncertainty? iii. How are EDBs accounting for the uncertainty of timing of when non-network solutions may become available or viable (due to technological developments or scale) and able to defer network investment requirements? iv. What forms of assurance do EDBs use, including external verification / challenge to provide confidence in the appropriateness of expenditure plans?
Why we are asking this question (Relation to regime)	*DPP reset* • We want to improve our understanding of what forms of assurance EDBs use to support EDB forecasts, including understanding the various approaches EDBs use to gain confidence in their expenditure plans • We have improved visibility of which categories of expenditure EDBs have greater confidence in within their expenditure plans. *Performance Analysis* • We are better informed and understand the rigour that goes into finalising AMP expenditure forecast • We can target and trend expenditure in areas of lower confidence

Area	Deliverability
Primary question	How are EDBs getting confidence that their expenditure plans are deliverable, particularly if they involve a significant increase from historic levels?
Additional questions to help frame responses	i. How are EDB forecasts accounting for availability of materials and skilled staff to deliver programmes of work if there are significant increases in expenditure forecasted? ii. What are the trade-offs between asset renewal / replacement and significant new connection work that EDBs make in forecasting, particularly where a step change in expenditure is forecasted? iii. How do EDBs assess achievability of delivery under different scenarios and forecasts?
Why we are asking this question (Relation to regime)	*DPP reset* • We better understand how EDBs will develop confidence in their delivery plans • We are better informed on how we could address key risks that forecasts are inflated, and plans are not deliverable *Performance Analysis* • We are better informed and understand the rigor that goes into ensuring the plans are deliverable to achieve the project outcomes stated within the Asset Management Plans