MAJOR ELECTRICITY USERS' GROUP

15 August 2014

John McLaren
Regulation Branch
Commerce Commission
By email to regulation.branch@comcom.govt.nz

Dear John

Low cost forecasting approaches for DPP

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Commerce Commission paper[1] "Low cost forecasting approaches for Default Price-Quality Paths" published 4th July.

2. This submission should be read in conjunction with MEUG's separate submission dated today on the Commissions DPP Main Policy Paper.

Low cost forecasting approaches for operating expenditure

3. MEUG has concerns that some costs incurred by all or some EDB in RCP1 may not flow through to RCP2 though be captured in the 2013 disclosure year data used for base year operating expenditure. Those costs are:

    a) Set up costs to comply with the Part 4 regime. For example we suggest there may have been significant set up costs to comply with information disclosure requirements and those high establishment costs will not be repeated in RCP2; instead costs will be more modest reflecting incremental changes; and

    b) Legal costs associated with merit review and or other judicial review claims associated with the introduction and clarification of the new regime.

4. MEUG suggest the Commission analyse the disclosed information to see if operating costs associated with these one off costs can be separated and whether the resulting predictive power of the model for forecasting operating expenditure is improved[2]. MEUG makes this suggestion in terms of the discussion under the heading "additional adjustments for costs not captured in our forecast" on page 17 noting paragraph 3.31 states "Any adjustments for step changes in future operating expenditure may be downwards, as well as upward."

---

[1] Web site http://comcom.govt.nz/regulated-industries/electricity/electricity-default-price-quality-path/default-price-quality-path-from-2015/,document URL http://comcom.govt.nz/dmsdocument/12080
[2] Figure C1 (p67) graphs the predictive power of the non-network operating expenditure model. Of all the forecasting models used this graph illustrates the very wide variation between actual and predicated costs.

5. Alternatively if the Commission does not believe some or all of the costs suggested as being one-off and unique to RCP1 should or can be separated out to arrive at a lower operating expenditure starting base for the 2013 disclosure year; then the Commission should consider EDB specific information such as monies spent on court proceedings as part of the "contextual factors" mentioned in paragraph 3.15.

6. The mention of "contextual factors" in paragraph 3.15 is necessary because of the prohibition on the Commission using comparative benchmarking on efficiency as explained in footnote 17. MEUG notes that if the Commission could use comparative benchmarking on efficiency then the opening year operating expenditure and capital expenditure baselines for all EDB in aggregate would be lower than the aggregate values in the DPP proposal. To that extent New Zealand is less efficient and consumers will be paying higher EDB line charges than otherwise. MEUG submits that this is a relevant contextual factor when considering initial operating and capital expenditure baselines, ie if in doubt then lower expenditure rather than higher baselines should be chosen.

Low cost forecasting approaches for capital expenditure

7. In paragraph 2.31 and footnote 8 the Commission seeks views on whether, and if so how, to report after the event differences between forecast inflation and actual inflation. Vector has mentioned this issue in prior submissions. The low cost forecasting approaches paper states (paragraph 2.31) "However, as we have noted a number of times in the past, in a regulatory setting Financial Capital Maintenance is applied on an ex ante basis. Therefore, we do not intend to wash up for any historical differences between actual and forecast inflation." MEUG agrees with the Commission's view.

8. MEUG agrees with the proposal to have a lower limit on capital expenditure forecasts for EDB that have previously forecast significantly more than they have spent as set out in paragraphs 4.22 to 4.24. As the paper notes (paragraph 4.24) "We do not scrutinise the businesses' forecasts, and are concerned to not impose a significant risk on consumers paying for investments that are forecast but never needed." While this is consistent with the low cost forecasting approach MEUG believes further analysis is needed to understand the materiality of this risk actually realised by consumers and therefore whether research to consider options to mitigate the risk in future are warranted.

9. Table 4.2 (page 30) ranks EDB by the percentage of non-network capital expenditure to total capital expenditure. The highest is Unison Networks with 24% and the lowest Aurora Energy, Centralines and OtagoNet with zero. This huge spread would, had readers not known they were all EDB, indicate a list of companies in totally different businesses. Something could be wrong here in terms of how EDB allocate and disclose costs to non-network capital expenditure. Whatever the reason MEUG suggest the Commission should be concerned about the possibility of over or under forecasting non-capital expenditure. In the absence of a firm understanding on the reasons for this wide divergence in the fraction of non-network to total capital expenditure; MEUG suggest the proposed limit be 50% rather than 200% with a rate higher than 50% allowed for smaller EDB up to a maximum of 100%. In other words the largest EDB would have a cap of 50% and the smallest EDB a cap of 100% with all other EDB pro-rata between these two limits. We think this is reasonable because larger EDB have the ability to manage multiple non-network projects and hence as a portfolio stay within a smaller limit than the smallest EDB where a single project may exceed too small a limit.

Low cost forecasting approaches for revenue growth

10. Figure 2.3 (paragraph 2.38) illustrates the pre-dominance of industrial and commercial user forecast demand compared to household sector demand growth as a result of expected high Auckland region GDP growth relative to other parts of New Zealand. MEUG agrees with the proposal by the Commission to seek disaggregated commercial and industrial sector data in order to model these two non-household classes separately[3].

11. MEUG agrees with the Commission continuing to use the all industries capital good price index rather than a composite as discussed in paragraphs B16 and B17 (pp 60-61) and , as he Commission notes, if needed EDB can apply for a CPP for detailed consideration of the particular circumstances of that individual EDB.

Low cost forecasting approach for disposal of assets and other income

12. No comment.

Yours sincerely

Ralph Matthes
Executive Director

[3] See discussed in paragraph 5.23, p40 and paragraph C9, p64)