

## Submission to the Commerce Commission

### Concerning

### Low Cost Forecasting Approaches for Default Price Quality Paths

#### Background

1. Network Tasman (NTL) appreciates the opportunity to submit on the Commission's Low Cost Forecasting Approaches for the DPP Determination.
2. NTL is also member of ENA and the PwC EDB Group and supports the broader submissions put forward by each of these parties.
3. This submission highlights NTL's primary areas of concern with the forecasting approaches the Commission is proposing for the forthcoming DPP reset.

#### Opex Forecasts

4. NTL submits that the base year opex allowance should not rely on a single year data point (2013) as this risks selecting an unrepresentative starting or stepping off point for the forecasting methodology applied to the 2015-2020 period. NTL considers averaging the 2013 and 2014 opex data would provide a more reliable and representative starting point for most EDB's.
5. NTL considers the 0% partial productive estimate incorporated in Opex forecasts to be optimistic and contrary to other evidence. On an anecdotal basis EDB's growing obligations concerning traffic management, health and safety, consenting requirements, land access and tree management and growing industry regulatory burdens all mean that it is now more costly and resource intensive to provide the same outputs than it was in prior periods.
6. NTL considers the constant energy intensity assumption for residential consumers used in the opex modelling to be dubious. This issue is addressed in more detail in the revenue growth section of this submission.

#### Network Capex Forecasts

7. NTL submits that 2014 capex estimates incorporated in the DPP financial model be updated with actual data from EDB 2014 Information Disclosures

8. NTL accepts the use of the Capex wash-up factor being applied to the difference between actual and forecast 2015 capex provided it includes capex relating to spur asset transfers and the outcomes can be symmetric – either positive or negative.
9. NTL acknowledges the Commission’s difficulties with using AMP data for forecasting capex over the 2015-2020 regulatory control period (RCP3).
10. However NTL has considerable reservations about the proposal to cap NW capex allowance in the DPP reset to 110% (or 120%) of historic levels. While NTL acknowledges revenue allowances on unspent AMP based capex allowances in RCP2 are problematic for the Commission the proposed solution is simplistic and ignores individual circumstances of EDBs.
11. There are a number of reasons why AMP forecast are not met in particular periods. This may be due to resource shortages, late delivery dates for equipment, consenting difficulties, commissioning problems and delays, unforeseen opex events (eg storms) taking priority and deferral due to changes in demands of customers. In many instances AMP projects are rolled forward into subsequent periods, generally they do not just disappear. Using past capex spend levels to cap revenue allowances for future capex spending is thus a blunt instrument that may cause perverse outcomes.
12. Revenue allowances based on the 110% limit of historic capex levels are problematic where smaller EDBs are scheduling major one off projects in the 2015-2020 control period. While the 110% limit may be adequate for business as usual capex, it is unlikely to support one off large projects. In NTL’s particular case a new GXP is scheduled for development in 2017 -19 on the south end of the network because Stoke GXP (6<sup>th</sup> largest in NZ) is reaching its physical limits for expansion. This will be the largest capex project ever undertaken by NTL. The 110% capex limit in the draft decision effectively excludes this project from any revenue allowance in RCP3. NTL’s options are to seek a CPP solution, request TPNZ to build the GXP or defer the project and take-on additional reliability / security risks. Each of these options will place additional costs for no benefit on NTL consumers and NTL is faced with a disincentive to invest.
13. NTL submits that if the Commission persists with the 110% capping mechanism it should make provision for a pre-approval mechanism for a DPP capex wash up allowance factor where an EDB commits, in RCP3, to a large one off project that was in the 2014 AMP but supporting revenue has effectively been excluded by the 110% capex capping mechanism applied in the reset process. The wash-up allowance factor could be similar to that developed to account for differences between forecast and actual capex for the 2015 year.

#### **Non Network Capex**

14. NTL also submits that in the Draft Reset Modelling NTL’s projected non-network capex for the 2019-20 year has been left out of the financial model (#9) and from the

outputs of capex model (#4) yet was included in the data inputs of the capex model (#4).

### **Real Revenue Growth**

15. Real revenue forecasts are material to the level of EDB's year on year MAR allowances and also feed into the  $\Delta D$  term to set the starting MAR level for the 2015-16 DPP.
16. The Commission is proposing a similar real growth forecasting methodology as was adopted for the RCP2 reset. NTL submits that the onus is on the Commission to demonstrate the "goodness of fit" this growth forecasting technique delivered over RCP2 now it can be compared against actual growth outcomes recorded by each EDB for 4 out of the 5 years. ENA has done some work in this respect and the outcomes are not particularly supportive of the Commission's technique when examined at EDB level.
17. The Commission has based real revenue forecasts for residential consumers on projected population growth statistics in local authority territories. In NTL's case residential real growth forecasts are solely based on Tasman District's population growth data. However in reality 13,400 or 35% of NTL's 32,090 residential ICPs are located within the Nelson City boundaries and so should be accorded the population growth estimates for that regional authority and not Tasman's.
18. In determining residential real growth the Commission has assumed consumption per residential consumer remains static over RCP2 (no change in energy intensity for this consumer category). From a historical perspective, for NTL and a number of other EDB's, this assumption appears challenging. Examining actual data for the first 4 years of RCP2 to 31 March 2014, NTL's consumption per ICP rather than being static has instead declined by an average of -1.0% pa. If the period is extended out to the last decade the rate of decline is -0.7% pa so the trend of decline has actually accelerated.
19. There are a considerable number of structural factors behind declining residential energy intensity measures and none of these are unique to NTL. Some of the factors observed by NTL include improving energy efficiency of lighting, heating and home appliances, home insulation initiatives and improving building quality standards, generally warmer winter temperatures, cold water washing and low delivery shower heads, smaller multi-unit dwellings, declining occupant numbers per dwelling, low wage/ income growth, responsiveness to rising delivered electricity prices and an exponential growth of PV installations. We see little reason for this trend not to stay put throughout RCP3.
20. Use of accurate real consumption growth trends for residential consumers in the DPP reset is fundamental because the Low User Regulations force high levels of line revenue to be obtained through kWh charges. EDB's thus have high exposure to forecasting errors.
21. NTL submits that the Commission should reconsider its assumption concerning static residential consumption per ICP for RCP3 and this may require detailed analysis of historic consumption trends based on actual EDB data.

22. NTL's SMEs are also showing declining energy intensity trends but at a slightly lower rate than for residential. Larger commercial and industrial consumers as a group have at best static trends in energy intensity.
23. The Commission's real growth forecasts feeds into the determination of the  $\Delta D$  term that converts MAR in revenue date terms into the starting MAR for the 2015-16 DPP. NTL submits that  $\Delta D$  term should reflect, to the extent possible, actual and known EDB real growth data for the 2 year adjustment period so there is a realistic prospect that MAR in revenue date terms is achievable in the 2015-16 year.
24. To address these concerns NTL supports the conclusions of the PwC submission concerning real revenue growth forecasts - either :
  - Abandon the use of the forecasting model and extrapolate real revenue growth from actual EDB historical data trends or
  - Include an ex post volume wash up in the DPP to correct of forecasting errors
25. The primary contact for this submission is:

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