

21 September 2011

Matthew Lewer
Regulation Branch
Commerce Commission
PO Box 2351
WELLINGTON

Dear Matthew,

UNISON SUBMISSION ON PROPOSED USE OF TRANSPOWER VOLUME GROWTH FORECASTS IN THE DPP RESET

The Commission proposes that it adopt Transpower's finalised volume growth forecasts that will be available in early October.

Unison responds as follows:

1. We welcome and support the Commission's attempts to identify more accurate volume forecasts.
2. Relative to the EA's 2009 forecasts, the indicative Transpower forecasts appear to better align with low population and GDP growth expected over the remainder of the regulatory period in Unison's regions.
3. It is important to recognise that the observation in the preceding bullet point is a relative assessment. Unison submits that Transpower's volume forecasts do not reconcile low population growth and GDP forecasts with the trend improvement in energy intensity of the New Zealand economy, as reported in MED's Energy Outlook. Transpower's forecasts imply a worsening of energy intensity for Unison's networks, as volume growth outstrips population and GDP growth. The Commission should address this apparent inconsistency in the forecasts – what factors are causing energy efficiency/intensity to go into decline? If there is no plausible explanation, then it would imply that one or more components of the forecasts are inaccurate.
4. Transpower generates energy demand forecasts as an intermediate step in developing peak demand simulations, from which it develops a plausible range of peak demands intended for use in grid planning. Hence, the key objective for Transpower's forecast appears to be in developing forecasts that account for uncertainty and therefore a 'P90' scenario of peak demands on which grid investments can be made. It is unclear how this modelling objective impacts on the accuracy of the mid-point for energy forecasts, and it is not evident from the report to what extent the energy forecast model was tested for forecast accuracy. This aspect is not addressed in the NZIER report either.

5. Unison has previously recommended the Commission test an approach whereby residential and commercial volume growth are driven by population and GDP growth respectively, adjusted for an energy efficiency factor based on historical trends. This approach would ensure internal consistency of the components making up the real revenue growth forecasts, and would promote more accurate forecasts at a network level. For example, we note that the Bay of Plenty energy growth forecasts in Transpower's forecast would still be dominated by relatively stronger growth in Tauranga, compared to Rotorua and Taupo and other parts of Bay of Plenty. It is not evident that the Commission's proposal to match regional forecasts to EDB's areas using weights calculated from historic GXP level electricity volumes would correct this issue.

6. Unison's expectation is that the Commission will undertake a quantitative evaluation of the various reasonably available forecasting approaches and resultant forecasts and adopt an approach that, objectively, is likely to provide the most accurate forecast of volume growth relating to each network. Appropriate statistical tests should be employed to assess likely forecast accuracy. The Commission should also evaluate whether some form of scaling could apply to Transpower's forecasts to better align the volume forecasts to the relevant network regions (e.g., by using relative population growth to allocate volume growth projections across regions that encompass multiple network companies, such as Bay of Plenty, Hawkes Bay).

Unison notes that all forecasts are likely to be wrong: the challenge is to identify the forecast that is likely to be least wrong. Overall, in the absence of the Commission providing a comprehensive evaluation of the different options for establishing volume forecasts, we are not in a position to either support, or disagree with, the use of Transpower's forecasts or forecasting approach. All that we can reasonably conclude at this stage is that Transpower's indicative forecasts are better than the EA's as they rely on more up-to-date input forecasts. More work must be carried out to assess whether these are the best forecasts that can reasonably be used in resetting the DPP.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Nathan Strong'.

Nathan Strong
General Manager Regulation and Pricing