COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

Incentivising efficient expenditure
Questions regarding totex, IRIS and innovation
For use by external stakeholders

This document provides questions to guide feedback on our 7 November 2022 workshop *"Forecasting and incentivising efficient expenditure for EDBs"*. These questions focus on totex, IRIS, and innovation and are intended to inform our review of the Part 4 input methodologies (IM Review).

Along with these questions we have published:
1. a model that demonstrates the broad financial equivalence of the treatment of opex and capex in the respective IRIS incentive mechanisms; and
2. a brief companion staff paper.

The workshop slides and staff working paper (*Electricity distributors' expenditure incentives under the current Part 4 approach and under a totex approach*) we published before the workshop are available here along with the recording of the workshop.

It would be useful if you could take these into account when answering the questions that follow.

Completed forms should be sent to im.review@comcom.govt.nz, with 'INCENTIVES SUBMISSION – [your submitter name]' in the subject line of the email. Please provide us with your feedback by 5pm Tuesday 6 December 2022.

If you have supporting documents that you consider would improve our understanding of the issues, please attach them with your response and reference them in your feedback below.

All completed forms and supporting documents provided to us in this context will form part of the record for the IM Review. We intend to publish completed forms and supporting documents provided to us to enable other stakeholders to engage with them throughout the IM Review. Any request that we not publish content in a completed form or supporting document provided to us must be clear and explicit with reasons supporting why that content is confidential or commercially sensitive. We will consider any such requests on their merits.

A. Questions relating to the problem of capex bias

In paragraph 12 of our staff working paper,[1] we define 'capex bias' as arising where the regulatory approach to setting price-quality paths financially incentivises investment in assets (capex) over alternatives such as demand response (opex), where those alternatives are more efficient. We do not use the term 'capex bias' to refer to situations where favouring a traditional network solution over a non-network alternative results in greater net benefits to consumers.

A1. Do you consider that we have accurately described the general problem of capex bias? If not, please provide further description.

Answer:

The IEGA is interested in this issue of 'capex bias' as it relates to EDB's motivations to contract non-network solutions from a third party. This is different from an EDB investing in the non-network solution itself – which is likely to be treated as capex.

Our view is that there would be very few instances when a contract with a third party for non-network solutions could be accounted for as 'capex'.

It's our understanding that if an EDB is contracting the service of a non-network solution from an external third party this contract is most likely to be accounted for as an operating expense (as the service provider has made any necessary capex). The only situation where a third party contract for non-network solutions might result in it being included as capex by the EDB (and included in the RAB) is if the payment was via a finance lease – but a finance lease arrangement seems unlikely.

However, the structure of the arrangement for payment for non-network solutions may be different / influenced by the EDB if it is purchasing the solution from a related party to the EDB. This could result in 'capex bias'.

It would be useful for the Commission to be explicit about how the costs of non-network solutions should be accounted for – that is, the situations when the cost would be opex, capex or unregulated revenue.

The Commission understands there are increasing opportunities for non-network solutions to offer efficient alternatives to traditional poles and wires. This potential is largely untapped in NZ currently. We suggest it is worthwhile the Commission investigating other barriers to uptake of these solutions (other than financial allocations). Feedback from the combined Electricity Authority and Commission 2019 workshop 'Spotlight on emerging contestable services' probably still provides useful information to make progress on non-financial impediments to the uptake on non-network solutions.

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[1] https://comcom.govt.nz/__data/assets/pdf_file/0025/296233/Staff-paper-for-Workshop-Forecasting-and-incentivising-efficient-expenditure-for-EDBs-1-November-2022.pdf

D. Questions relating to innovation and sandboxing[2]

D1. **Currently, the implementation details of the innovation project allowance and the size of the allowance paid out following successful projects are determined as part of the DPP reset rather than in the IMs. Are there any changes to the IMs[3] we should consider to better enable innovation?**

Answer:

The IEGA has always supported enabling EBDs to invest in innovation. It's interesting to think about the definition of 'innovation': – is it

- Is it importing into NZ a technology or process that has never been tried in NZ before? Are we making the most of innovative practices tested and in place overseas or is there an issue with sourcing / understanding relevant information about overseas innovative practices across our 29 EDB?
- Or is it something completely novel that has not been tried in NZ or overseas before? The latter is obviously more risky – and some projects may fail - but also (may be) a smaller proportion of the 'innovation' opportunities.

We understand that the current innovation allowance is limited or insufficient for investigating the range of innovation opportunities. The IEGA supports implementation of a contestable government fund for innovation in providing line function services – similar to the Government Investment in Decarbonising Industry (GIDI) Fund. A criteria should be that any successful innovation must be made available to other EDBs (the GIDI Fund already deals with issues relating to IP developed by the project). This government investment would be improve efficiency in the value chain representing approximately 30% of household's electricity bills.

D6. **What are they key ingredients of an effective regulatory sandbox? What aspects of the regulatory sandboxes implemented by the AER[4], OEB[5] and Ofgem[6] do you consider should be implemented under Part 4 regulation and why are these elements important for your business?**

Answer:

The IEGA has not reviewed the international experience with sandboxes. However, NZ should be in a good position to take the best from these experiences and put in

2 See "Forecasting and incentivising efficient expenditure for EDBs" slides 54-59: https://comcom.govt.nz/__data/assets/pdf_file/0029/298055/Forecasting-and-incentivising-efficient-expenditure-for-EDBs-Full-slide-deck-07-November-2022.pdf

3 See clause 3.1.3(1)(x) and the definitions of 'innovation project' and 'innovation project allowance' under clause 1.1.4(2) of the Electricity Distribution Services Input Methodologies Determination 2012: https://comcom.govt.nz/__data/assets/pdf_file/0017/60542/Electricity-distribution-services-input-methodologies-determination-2012-consolidated-20-May-2020-20-May-2020.pdf

4 Regulatory Sandboxing – Energy Innovation Toolkit: https://www.aer.gov.au/networks-pipelines/regulatory-sandboxing-%E2%80%93-energy-innovation-toolkit#:~:text=Regulatory%20sandboxing%20aims%20to%20help,cheaper%20energy%20options%20for%20consumers

5 OEB Innovation Sandbox: https://www.oeb.ca/_html/sandbox/index.php

6 Ofgem – What is a regulatory sandbox?: https://www.ofgem.gov.uk/publications/what-regulatory-sandbox

place a mechanism that enables more regulatory flexibility while successfully managing any risks.
IEGA members will be watching this development with interest to understand how we can contribute to creating a more efficient system for the long term benefit of consumers.