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Dear Charlotte

## **Feedback – Incentivising efficient expenditure regarding totex, IRIS and innovation**

### **Introduction**

1. As a part of the Input Methodology Review the Commerce Commission (the Commission) has conducted a targeted consultation on totex, IRIS and innovation.
2. The Commission released a Staff working paper “Electricity distributors’ expenditure incentives under the current Part 4 approach and under a totex approach”<sup>1</sup> on 1 November 2022, in anticipation of the workshop which was held on 7 November 2022 “*Forecasting and incentivising efficient expenditure for EDBs*”<sup>2</sup>.
3. The Commission requested feedback on questions<sup>3</sup> regarding Incentivising efficient expenditure focused on totex, IRIS and innovation on 22 November 2022 after the workshop.
4. Orion appreciates the opportunity, given to industry stakeholders by the Commission, to respond to the questions published on the Commission’s website subsequent to the workshop.

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<sup>1</sup> [Staff-paper-for-Workshop-Forecasting-and-incentivising-efficient-expenditure-for-EDBs-1-November-2022.pdf \(comcom.govt.nz\)](#)

<sup>2</sup> [Forecasting-and-incentivising-efficient-expenditure-for-EDBs-Full-slide-deck-07-November-2022.pdf \(comcom.govt.nz\)](#)

<sup>3</sup> [https://comcom.govt.nz/\\_data/assets/word\\_doc/0032/298760/IM-review-2023-Incentivising-efficient-expenditure-Workshop-follow-up-questions-22-November-2022.docx](https://comcom.govt.nz/_data/assets/word_doc/0032/298760/IM-review-2023-Incentivising-efficient-expenditure-Workshop-follow-up-questions-22-November-2022.docx)

## Summary

5. We have reviewed the request which was published on the Commerce Commission's website.
6. This submission provides feedback on the questions posed by the Commission.

## Other Feedback

7. In principle, Orion supports the submission of the Electricity Network's Association.

## Purpose of Part 4 of the Act

8. *"The purpose of this Part is to promote the long-term benefit of consumers in markets where there is little or no competition by promoting outcomes that are consistent with outcomes produced in competitive markets such that suppliers of regulated goods or services".<sup>4</sup>*
9. We note that the Commission is specifically looking at these incentives, including a totex approach, under the Part 4 regime.

## Feedback on expenditure forecasting

The following section is an extract of the Questions posed by the Commerce Commission on 23 November 2022 with Orion's responses.

### A. Questions relating to the problem of capex bias

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

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- A2. Do you consider we have accurately described the potential issue with regulatory financial incentives resulting in or reinforcing capex bias? If not, please provide further description.**
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Answer: Yes

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**If relevant, we would welcome examples of capex bias from your business. Please explain the source(s) of the capex bias.**

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<sup>4</sup> Section 52A <https://www.legislation.govt.nz/act/public/1986/0005/latest/whole.html#DLM1685404>

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A3.

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Answer:

The current environment has meant that operationally it appears that shorter term Opex solutions provide interim solutions until a longer-term Capex solution can be implemented.

Opex solutions are more of a discovery and market testing process than traditional capex solutions therefore EDBs are more likely to have forecast capex solutions in their AMPs. If then, during a regulatory period an alternative solution provided by an opex approach is explored there is a risk of an opex IRIS penalty in the subsequent DPP period. Conversely, there is a potential capex reward however the impact of an opex penalty is perceived to be more immediate and material than a capex reward and more impactful from a cashflow perspective.

Conversely from a long-term perspective, the opening RAB is a significant factor in the building blocks approach to setting revenue.

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**A4. In your view, do regulatory financial incentives under Part 4 DPP/ CPP regulation (RAB-based building blocks approach with WACC uplift, with opex and capex IRIS) contribute to capex bias (if any) in your business?**

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Answer:

We submit that the incentive that contributes to capex bias is the IRIS incentive.

While there is the likelihood that Capex can be preferred over Opex as it forms part of the building blocks for allowable revenue, the Commission has also indicated that there is no empirical evidence that this occurs.

Of note however, the inclusion of customer connection capex in the IRIS assessment, is troublesome. Orion has seen new connections exceed 5,000 on the network in recent years over a forecast of ~3,000. The IRIS penalises any increase in forecast connections from customer-initiated growth. One option would be to adopt a similar approach to Chorus' price quality path of a baseline allowance as explained in their reasons paper<sup>5</sup> point 4.287 *"Connection capex is capex that is directly incurred by Chorus in relation to connecting new end-user premises where the communal fibre network already exists or will exist at the time of connection. Connection capex consists of two components, a connection capex baseline allowance, which is determined prior to the start of a regulatory period, and a connection capex variable adjustment which is used to washup the differences in the forecast volume of new connections with the actual number of new connections over the regulatory period. Our decisions set out in this paper are for the connection capex baseline allowance for PQP1"*

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<sup>5</sup> [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0028/273475/ChorusE28099-price-quality-path-from-1-January-2022-Final-decision-Reasons-paper-16-December-2021.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0028/273475/ChorusE28099-price-quality-path-from-1-January-2022-Final-decision-Reasons-paper-16-December-2021.pdf)

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It may be worth exploring a similar mechanism and not adopt a fully-fledged totex IRIS approach, nor reindexing to create a synthetic RAB with fast and slow money for BBAR purposes.

IRIS specific solutions could also include:

- A tiered approach - Incentives only apply after a certain threshold has been met between actual expenditure and the allowances.
- A confidence dependant approach – a higher sharing rate applies to categories which the Commission has greater confidence in the ability to forecast e.g., asset replacement and renewal with low incentives where expenditure is harder to forecast
- Exclusions from the IRIS such as new connections expenditure.

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**A5. How important are regulatory financial considerations to your business when choosing between different solutions? We would welcome specific examples (reflecting information from actual business decisions) that illustrate how regulatory financial considerations have been considered.**

Answer:

Not all business cases necessarily consider the capex vs opex option when exploring solutions when expenditure is forecast for the AMP. Much of this can happen in later years during the DPP when the most suitable and new options available at the time are known and more detailed business cases are developed.

Examples of this are in the data and digitisation space (in house capex versus software as a service) and provision of radio communications (in house capex versus radio as a service) where we have traditionally taken a capex approach. There are also other drivers for using a capex approach including resilience and service surety given EDBs roles as lifeline utility businesses.

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**A6. To help us understand the overall size of the problem of capex bias, we would appreciate your assessment of *current* opportunities where Opex solutions would be more efficient – for example, from your most recent asset management plan. We are also interested in your expectation of how (quantitatively or directionally) the opportunities might change over the *next decade*, for example, due to emerging technologies.**

Could you please advise or estimate:

- the aggregate size of the pool of expenditure (capex and opex) where interchangeable capex and opex solutions are currently available
  - of that overall pool of expenditure, the total value of opex solutions chosen.
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**If you expect this to change in the future, please estimate the future values.**

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Answer:

The rules around capitalisation of assets are clear so the choice between capitalisation of an asset to expensing (operationally) would be limited from an allocation perspective. There are limited instances where we would be able to substitute opex for capex. It is difficult to identify opex solutions for lifecycle renewal and replacement such as cross-arms or insulators.

As examples, we would consider opex solutions more efficient for:

- Data and digitisation opex for third party cloud-based solutions.
- Interim flexibility opex service to defer medium term capex, such as substation builds.
- Demand management arrangements for contingent events

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## **B. Questions relating to a potential solution to capex bias: totex approach**

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**B1. Should we consider introducing a totex approach for EDBs as a solution to capex bias and/or simplification of financial incentive mechanisms? Should we introduce a totex approach for other regulated services? Please provide your reasons.**

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Answer:

Orion cannot comment on other regulated services and the impacts of these on their resultant services.

In our opinion, the totex approach should be used to simplify the financial incentive mechanisms. The main reason for Orion, was to reduce the complexity of the IRIS mechanism in making short-term choices between capex and opex against the allowances for IRIS purposes.

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**B2. If you consider we should adopt a totex approach, do you agree with the approach described in the staff working paper? If not, please explain why not and what you would change.**

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Answer:

Our submission is for a totex “lite” approach which primarily focusses on addressing the impacts of IRIS as opposed to a complex implementation of a synthetic RAB with slow and fast money outcomes.

A totex “lite” approach could take the form of addressing the incentive mechanisms (through the recoverable costs as is currently applied) without embedding it into the building blocks for allowable revenue.

The Boston Consulting Group Report<sup>6</sup> also proposed under the second point under k:

*“We propose that:*

- *Until a totex approach is implemented, we recommend adjusting the base-step-trend opex spend assessment to include adequate forward-looking considerations, accounting for factors like increased cyber security costs and non-network solutions.”*

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**B3. If you consider we should adopt a totex approach, please provide your views on:**

- **expected benefits for your business (relative to the current RAB-based building blocks approach with WACC uplift, opex and capex IRIS)**
- **expected implementation costs and timelines for your business**
- **any other considerations**

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Answer:

The totex approach should be used as a mechanism to simplify the IRIS incentive with the same retention factor outcome and smoothing approach used in the capex IRIS incentive over the DPP period. This would reduce the administrative burden as opposed to adding complexity to the BBAR through a revised RAB approach.

If we were to implement the new RAB approach as proposed by the Commission then EDBs would need to consider:

- the details of the changes the Commission is proposing in relation to percentages or classes of RAB that will need to be included in the synthetic RAB to calculate the “fast” and “slow” money.
- The various systems used by EDBs to calculate the RAB, whether spreadsheet based or financial system based and how the new rules would be applied to accommodate the new RAB rules.

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<sup>6</sup> <https://web-assets.bcg.com/b3/79/19665b7f40c8ba52d5b372cf7e6c/the-future-is-electric-full-report-october-2022.pdf>

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Once we understand the extent of the re-indexation proposed by the Commission, we would be in a better position to assess the work involved in reconfiguring our asset registers. This would require staff time and consultants and estimate the cost to be in excess of \$100k.

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## C. Questions relating to current expenditure incentive mechanisms

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- c1. The model and paper published with these questions are intended to demonstrate the effects of the capex and opex IRIS incentives on investment choices. With this information now available, do you consider that there is broadly financial equivalence between the incentives on opex and capex?**
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Answer:

The staff paper for the Workshop<sup>7</sup>, points 64 to 74 explain the theory of opex and capex IRIS mechanisms well. Point 75 of the staff paper goes on to mention that “The WACC uplift means that spending capex will result in a greater than midpoint return over the life of the asset. The WACC uplift was introduced to reflect the detrimental outcomes from underinvestment. This also clearly provides incentives to spend (and not reduce) capex.”

The DPP3 reasons paper<sup>8</sup>, point 6.44 mentions that “Because of the change in the WACC, the retention factor for opex has reduced to 23.5%. To ensure distributors have a consistent incentive to spend both opex and capex, and do not favour capital solutions over operating ones, we have equalised the capex retention factor with the opex one.”

The IRIS equivalence model<sup>9</sup> and discussion paper<sup>10</sup> explains the equivalence sufficiently. One potential shortcoming affecting the opex retention factor is the WACC setting, as it was in the final decision for DPP3 when the WACC percentile was reduced so that the opex retention factor resulted in a similar capex retention factor of 23.5% A fixed 23.5% retention factor in a totex approach would also reduce the need to make trade off decisions between opex and capex.

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<sup>7</sup> [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](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)

<sup>8</sup> [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0020/191810/Default-price-quality-paths-for-electricity-distribution-businesses-from-1-April-2020-Final-decision-Reasons-paper-27-November-2019.PDF](https://comcom.govt.nz/_data/assets/pdf_file/0020/191810/Default-price-quality-paths-for-electricity-distribution-businesses-from-1-April-2020-Final-decision-Reasons-paper-27-November-2019.PDF)

<sup>9</sup> [https://comcom.govt.nz/\\_data/assets/excel\\_doc/0040/298759/IM-review-2023-Incremental-rolling-incentive-schemes-equivalence-model-22-November-2022.xlsx](https://comcom.govt.nz/_data/assets/excel_doc/0040/298759/IM-review-2023-Incremental-rolling-incentive-schemes-equivalence-model-22-November-2022.xlsx)

<sup>10</sup> [https://comcom.govt.nz/\\_data/assets/pdf\\_file/0039/298758/IM-review-2023-Incremental-rolling-incentive-schemes-equivalence-staff-discussion-paper-22-November-2022.pdf](https://comcom.govt.nz/_data/assets/pdf_file/0039/298758/IM-review-2023-Incremental-rolling-incentive-schemes-equivalence-staff-discussion-paper-22-November-2022.pdf)

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- c2. Some suppliers submitted to us that expenditure allowances are not currently substitutable between capex and opex (i.e., the incentives are not financially neutral).<sup>11</sup> However, with equalised incentive rates, the effect (over the relevant period of the saving or overspend) should make suppliers financially indifferent to substituting between opex and capex solutions.**

**If you consider capex and opex are not substitutable under the current IRIS settings, please provide some examples from your business demonstrating why you were not financially indifferent in choosing between opex and capex solutions.**

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Answer:

The treatment of the opex IRIS incentive is not smoothed over the 5-year period like the capex IRIS. Furthermore, the IRIS mechanism has not been easily understood up until now (including the retention factor component).

Not having a good understanding of the impact of IRIS (“penalty”) and current expenditure overruns due to the current economic climate (rising fuel costs, inflation, and supply chain issues) seems that, either way there will be a penalty.

The Commission has demonstrated that there is indifference in substituting capex with opex. If this is the case, we do consider that the incentive mechanism, being equalised, should not be a factor in making an expenditure decision as long as an overspend in opex has a very similar outcome to an underspend in capex.

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- c3. How important is the fact that IRIS does not capture the impact of savings that extend beyond the IRIS horizon (i.e., the carry-forward term of five years)? Can you provide us with examples of projects where future savings are not included within the IRIS horizon? Could you propose potential solutions to this problem (including through the IRIS mechanisms)?**

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Answer:

No Comment

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- c4. Do you consider IRIS in your business decision-making processes? If so, which stage(s) of your decision-making processes consider IRIS when contemplating substitutable solutions (whether opex or capex)?**

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Answer:

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<sup>11</sup> We set a revenue cap for each non-exempt EDB within which they may choose opex and capex as they see fit. We have separate incentive mechanisms for opex and capex, so the EDBs choice affects the incentive amount they receive. If incentive amounts for opex and capex are equivalent, then these EDBs should be financially indifferent between opex and capex.



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Orion does not consider substitutable solutions between capex and opex from an asset management and replacement point of view in the planning stages of AMP forecasting. Refer to answer to question A5.

We do consider the impact of IRIS against the allowances when undertaking financial planning (forecasting and budgeting) to see what impact IRIS may have on revenues and ability to service Orion's financial commitments in future years. (i.e., financeability). This is where interchangeable capex vs opex, or totex would be a useful approach applied to simplify incentives.

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**c5. Suppliers have noted that the complexity of the current incentive mechanisms is a problem in the regulatory regime. How could the incentive mechanisms be simplified while still achieving the desired outcomes?<sup>12</sup>**

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Answer:

We recommend the following simplifications:

- a) By providing one IRIS incentive assessed under totex e.g., recast IRIS as a totex incentive, and
- b) Carve out certain categories of capex so they do not enter the IRIS i.e., customer connections or, apply a variable adjustment for connection capex similar to that applied for Chorus e.g. the difference between the baseline allowance, based on forecast connection volumes, and the actual connection volumes. Chorus's capex allowance increases if actual connections exceed forecast connections and Chorus receives a benefit if it can connect additional users (above the baseline forecast) at a lower cost than the unit cost

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**c6. Changing the current IRIS mechanisms to apply different incentive rates to different types of expenditure (such as connection capex) would likely increase the complexity of the incentive schemes. Would the benefits of this change outweigh the increased complexity?**

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Answer:

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<sup>12</sup> The desired outcomes are set out in Section 52A (1) (a)–(d) of Part 4 of the Commerce Act 1986.

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Connection capex can be under-forecast where we have not foreseen growth using our data sources and larger connections which currently falls under the Capex allowance (schedule 6b of the IDs). It would depend on whether the Commission can, with relative ease remove the connection capex from the IRIS calculation. If this raises more complexity of the incentive schemes then the benefits may outweigh the increased complexity. Orion recommends that the Commission provides an example of the impact on an overspend in order to evaluate whether the benefits outweigh the increased complexity.

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**c7. If we were to remove or make significant changes to IRIS, what would an appropriate alternative approach be that would better promote one or more of the overarching objectives of our IM Review?<sup>13</sup>**

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Answer:

The IRIS mechanism serves its purpose in sharing benefits with consumers.

Setting the DPP4 Opex and Capex allowances at a level which will ensure EDBs can maintain and replace assets is in the long-term interest of consumers.

We therefore do not necessarily recommend removing the IRIS mechanism entirely. However, we recommend that targeting a totex “lite” approach by evaluating opex and capex together for IRIS would assist in simplifying the IRIS incentive for regulated businesses.

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**c8. If we were to move to a totex approach, we would need an amended incentive mechanism. What could an incentive mechanism look like? One example is Ofgem’s totex incentive mechanism (TIM).<sup>14</sup>**

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Answer:

Ofgem’s TIM assigns confidence levels in base expenditure “*based on our confidence in our ability to independently set expenditure allowances in respect of those costs:*

- *"high-confidence" baseline costs are those costs for which we have a high level of confidence in our ability to independently set a cost allowance*
- *all other baseline costs are categorised as "lower confidence" baseline costs".*

This approach seems reasonable and aligns with levels of uncertainty.

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<sup>13</sup> The three overarching objectives for the IM Review are set out at para X20 of the [Part 4 Input Methodologies Review 2023 decision-making framework paper](#), which we published on 13 October 2022.

<sup>14</sup> See section 10 of Ofgem’s Decision – RII0-2 Final Determinations – Core Document [https://www.ofgem.gov.uk/sites/default/files/docs/2020/12/final\\_determinations\\_-\\_core\\_document.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2020/12/final_determinations_-_core_document.pdf).

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Orion's view is that we would want an easily understandable IRIS incentive mechanism without adding complexity. This would be in the form of a totex "lite" approach when assessing the expenditure against incentives and not for part of the building blocks of allowable revenue at this stage.

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- c9. For Transpower's IPP, we understand from stakeholders that the determination of the 'baseline adjustment term' has introduced significant complexity and uncertainty, potentially undermining incentives to achieve efficiency savings. If we were to remove this adjustment term, what other adjustments to the IPP IRIS mechanism do you consider would be necessary to achieve its purpose?**
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Answer:

No comment as it applies to Transpower.

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## **D. Questions relating to innovation and sandboxing**

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- 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<sup>15</sup> we should consider to better enable innovation?**
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Answer:

The rules and process for the innovation allowance are restrictive to innovate. In addition, EDBs are not compensated for the innovation until after successful completion of the project.

There is probably no need to make any changes to the IMs if the innovation allowance is carefully designed and is sufficiently covered in the DPP reset.

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<sup>15</sup> 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](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)

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We support the need for regulatory sandboxing in the framework and risk sharing between regulated businesses and consumers on innovative projects. This is important to provide more flexibility and access to innovation allowance especially where market regulation rules require relaxing or outcomes may be riskier but learnings will be beneficial for the sector even if unsuccessful.

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**D2. Are there innovative projects or initiatives in the supply of electricity distribution services that you consider the current IM and DPP settings prevent you from doing? If so, it would be helpful if you could give examples of business cases you did not take forward or that you consider would not be possible under the current regime.**

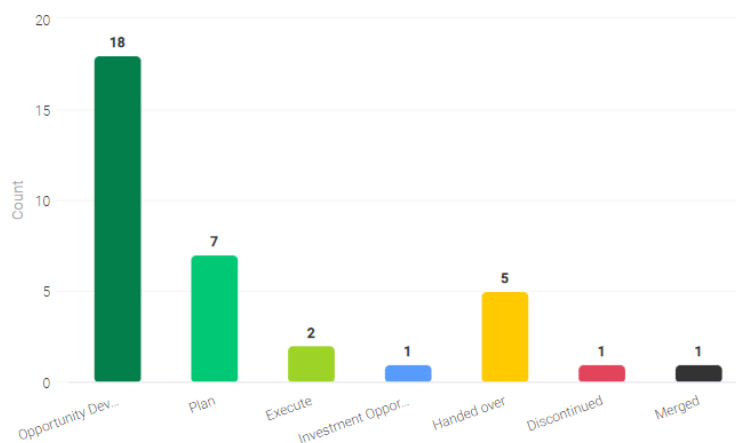
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Answer:

Orion has been working with retailers and aggregators to design simple and attractive customer propositions for households and communities that reward consumers for shifting their electricity use.

This is a project which involves partnering and will not be covered under the innovation allowance but will provide benefits to the network. A regulatory sandbox would be useful for this project.

Orion implemented an Innovation Pipeline in April 2022 and have had 35 ideas submitted to date, including 6 in response to opportunities through engagement with external stakeholders. These ideas are at various stages of development as shown below.



An example of an initiative that is in execute phase, that we do not think would be possible to fund under the current regime is Resi-flex. This is a collaborative initiative with Wellington Electricity that aims to develop and trial novel commercial mechanisms that incentivise residential flexibility in partnership with flexibility suppliers.

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Due to the complex nature of flexibility and consumer behaviour, we are utilising a design thinking approach (rather than traditional project management approaches) to understand the challenges and explore solutions. We have started with a 'discover and define' phase to identify and establish user requirements from across the flexibility supply chain, including networks, flexibility suppliers and consumers. Our next phase will involve development of commercial mechanisms, including a global scan to inform possible arrangements. The user requirements will be informing the evaluation criteria use to shortlist commercial mechanisms to take forward into real-world trials. At this stage, we intend to partner with flexibility suppliers to package value from the commercial mechanisms being trialled (alongside other value streams) into offerings that incentivise flexibility from residential consumers.

It is not clear whether this initiative fits within the definition of 'electricity lines service'. While the objectives and success criteria are consistent, the approach taken will be refined at each stage based on the learnings to improve the likelihood of success or determine whether the project should be closed.

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**D3. Innovative activities and projects can be riskier than business-as-usual activities and projects. Can you describe the downside risks associated with innovation under the current regulatory rules, and if possible, quantify those risks?**

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Answer:

We agree that innovative projects can be riskier and in a competitive environment these would be classified as research and development for customers. The risks under the current regulatory are that:

- Innovation does not take place without the necessary funding or uncertainty that funding will be available for these projects.
- By its nature innovation is inherently risky with no guarantee that the outcome pursued will be successful e.g., there is a risk of failure. If there was no risk of failure and the benefits were known, it would not be sufficiently innovative and should be assessed/delivered as a BAU project. As funding can only be sought retrospectively the downside risk is that the innovation allowance will not be approved because the outcome was not successful.
- Please refer to the Conclusion and Discussion Points (page 19 and 20) included in our innovation allowance of June 2021<sup>16</sup>

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<sup>16</sup> [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0029/279722/Orion-Innovation-Allowance-Application-June-2021.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0029/279722/Orion-Innovation-Allowance-Application-June-2021.pdf)

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A 'safe-to-fail' culture is necessary for innovation. The current process for accessing the innovation allowance does not support this or innovation methods best suited to tackle complex challenges. UK Power Networks Project Shift, which is similar to Resi-Flex mentioned above, was funded via Ofgem's Network Innovation Allowance (NIA) and led to the world's first low voltage flexibility tenders. However, the success cannot be attributed to that project alone as it builds on the learning from several previous innovation projects prior to that over a number of years. This highlights the importance of a balanced portfolio of projects to manage risk. In the 2021 Annual Summary, UK Power Networks reported £283.6M saving from innovation through the implementation of 50 innovative solutions through many more projects.

To minimise the risk of failure and duplication, it is important that learning is shared openly between networks. We would encourage knowledge sharing and IP developed through Innovation Allowance funded projects to be shared. This allows for greater learning, encourages collaboration between networks and the benefits to be leveraged more widely for the good of all electricity consumers

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**D4. Given that innovation is risky, who do you consider is better suited to bear the downside risk under Part 4 regulation – suppliers or consumers? What is your rationale for this?**

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Answer:

While we believe that we do our best to provide innovative solutions to our customers, competitive businesses are not constrained to regulatory frameworks and associated ROI limitations. The risk is generally therefore borne by the business and rewarded accordingly when consumers adopt the innovation.

It is better that downside risk in regulated business are therefore shared between suppliers and consumers while taking into consideration Part 4 regulation.

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**D5. What should compensation look like for the downside risk retained by suppliers? What level of compensation is required to enable efficient innovation considering these downside risks?**

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Answer:

We are not sure what compensation should look like for downside risk should look like, and rather submit that the design of the innovation allowance should include the requirement include the following:

- The learning objectives
  - Outcomes sought in order of priority
  - Triggers for assessing project failure or divergence from the outcome and how the decision to proceed or not will be made
  - Documenting any new beneficial outcome discovered as a part of the process.
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**D6. What are the key ingredients of an effective regulatory sandbox? What aspects of the regulatory sandboxes implemented by the AER<sup>17</sup>, OEB<sup>18</sup> and Ofgem<sup>19</sup> do you consider should be implemented under Part 4 regulation and why are these elements important for your business?**

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Answer:

Key ingredients we consider important for an effective regulatory sandbox are:

- Application process to access funding
- Fast turnaround on the rule making process e.g., less than 8 weeks duration with one round of consultation.
- Clear demarcation between sandboxes and the use of the innovation allowance e.g., sand box could be more appropriate for larger or more complex projects
- Funding should be up front
- Upfront funding allows investment that may not have occurred otherwise.
- The ability for cross sector players to work together on an innovation will be important for supporting energy system outcomes.

The Australian Energy Market Commission presented to Flexforum in November 2022. They highlighted some of the key ingredients which included:

- Equipping the regulatory framework to respond to rapid changes in the energy sector
- Encourage innovation in energy markets which has the potential to contribute to long-term interests of consumers
- Provide innovators with a clearer process for approaching market bodies for feedback.

Waivers should:

- provide time-limited regulatory relief from rules to eligible trials
- aimed at proof-of-concept trials facing regulatory barriers
- Maintain adequate consumer protections.

It could be used where reasonable prospect of benefit to consumers and where a permanent rule change would be hampered through inadequate information.

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**D7. To what extent should a regulatory sandbox regime under Part 4 focus on each of the following: advice, rule exemptions, trial rule changes and financial incentives?**

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<sup>17</sup> 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>

<sup>18</sup> OEB Innovation Sandbox: <https://www.oeb.ca/html/sandbox/index.php>

<sup>19</sup> Ofgem – What is a regulatory sandbox? <https://www.ofgem.gov.uk/publications/what-regulatory-sandbox>

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Answer:

Refer to D6 regarding waivers. Financial incentives could be based on revised DPP3 innovation allowances for DPP4.

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*D8.* **What projects do you have planned that would benefit from the implementation of a regulatory sandbox?**

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Answer:

Orion has 22 opportunities for development in its innovation pipeline of work. None of these have been considered for a regulatory sandbox approach in the absence of a regulatory sandbox incentive in the current regime.

We do support Flexforum who have also indicated that regulatory sandboxes will be useful in supporting innovation in the regulated sector.

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## Concluding Remarks

Thank you for the opportunity to provide feedback. I do not consider any part of this feedback as confidential.

If you have any questions or queries or aspects of the submission which you would like to discuss, please email [rob.tweedie@oriongroup.co.nz](mailto:rob.tweedie@oriongroup.co.nz).

Yours sincerely

Rob Tweedie

**Regulatory Manager**