Orion

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**Submission on EDB DPP4 Draft Decision**

## Background

The Commerce Commission (the Commission) published the "Default price-quality paths for electricity distribution businesses from 1 April 2025 – Draft decision" on 29 May 2024, requesting stakeholder feedback.

We have reviewed the paper and provide submission to the Commission's questions in the attached Appendix A.

Orion has prepared a joint submission with Wellington Electricity and Vector on three discrete issues (decisions C6, O4.1 and O4.2). That submission should be read alongside the current submission. The detailed points in the joint submission have not been replicated in this submission.

We have contributed to, and support, the joint submission from the Big6 (Vector, Orion, Wellington Electricity, Aurora, PowerCo and Unison) on reopener guidance.

We have also contributed to, and generally support, the submission from Electricity Network Aotearoa (ENA). Where there are differences, the position articulated in this submission should be considered as the Orion position.

## Summary

While the bulk of our comments are provided in the Appendix, we would like to highlight some of our key points here:

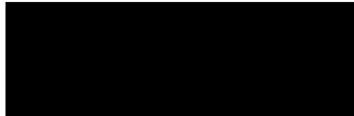
- The proposed increase in capex allowances is insufficient to enable EDBs to deliver a safe and reliable service to customers that will support future services and is not in the best, long term interests of customers.
- Orion does not consider that the proposed adjustment to capex allowances to account for forecast capital contributions is appropriate. It does not create the right incentives for Electricity Distribution Businesses (EDBs).
- We have concerns around the Commission's draft decisions around the choice of escalators for capex and network opex, although we are comfortable with the approach proposed for non-network opex.

- We welcome the proposed changes to the INTSA regime but would like to see the proposed allowances increased to ensure that this regime does not hinder innovation and the utilisation of non-traditional solutions.
- Orion supports the acceptance of the five proposed step changes, and the proposed changes in the assessment criteria. But we do not agree with the proposed 5% aggregate cap across all of the step changes.
- We support the Commission's decision to continue with a five year regulatory period.

## Concluding Remarks

We do not consider any part of this submission to be confidential. Please do not hesitate to contact Kelly Chapman on [redacted] if you wish to discuss our submission.

Yours sincerely



Dayle Parris

**Head of Regulatory and Commercial**

# Appendix A- Orion's Feedback Specific Questions

## Capital expenditure (capex)

### 1. Capex

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|---|---|
| *C1* | *Use EDB 2024 AMP forecasts as the starting point for setting capex allowances.* |
| *C2* | *Set the capex allowance in constant dollars based on the lower of an EDB's total forecast capex or 125% of its historical reference period capex, with an adjustment for forecast capital contributions.* |
| *C3* | *Use a five-year historical reference period for setting capex allowances [2019 to 2023 for the draft and 2020 to 2024 for the final determination] with an additional cost escalation adjustment.* |
| *C4* | *Include an allowance for the cost of financing, scaled in proportion to the capex allowance.* |
| *C5* | *Include an allowance for the value of considerations for vested assets and spur assets equal to 2024 AMP forecasts.* |
| *C6* | *Use the All-Groups CGPI forecast with an additional adjustment to escalate the constant price capex allowance to a nominal allowance.* |

*Views/Response:*

**Changing environment since DPP3**

Orion acknowledges that the Commission is preparing its decisions on DPP4 during a period of change and unknowns for the energy sector.

Electricity will play an increasing role in the New Zealand economy as the economy decarbonises and electrification becomes increasingly widespread. As the Commission notes in the draft reasons paper, there are uncertainties around what this will mean for networks and what might need to occur to support this transition. But it is critical that the appropriate settings and incentives are in place during DPP4 to ensure that EDBs are in a position to effectively support this transition, by building and maintaining appropriate networks and demand coordination, and ensuring that customer connections are available when required.

Inflation has significantly increased since decisions were made on DPP3. These increases are happening across the economy. Within Orion's local area, for example, local councils are putting up their rates bills in ranging from 9.4% to 17.9%[1] for the coming year. These increases are on top of increases in recent years and are in addition to further rate increases in subsequent years. Councils are saying that these increases are due to increased costs for maintaining their assets and services,

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[1] Christchurch City Council - Council confirms plan to secure bright future for Christchurch and Banks Peninsula : Newsline (ccc.govt.nz)
Waimakariri District Council - A Prudent Plan that Enables Growth – Council's Long Term Plan | Waimakariri District Council
Environment Canterbury Council locks in Long-Term Plan: $337m investment in first year | Environment Canterbury (ecan.govt.nz)
Selwyn District Council - Selwyn District Council - Selwyn District Council adopts 10-year plan

in particular the increased costs from inflation, servicing debt, insurance and auditing costs[2]. EDBs are facing these same costs and same cost increases.

While other businesses have been able to pass these costs onto customers each year, EDBs have had to absorb much of the costs throughout the regulatory period. Cost increases are only able to be reset at the end of each period, creating significant pressures on EDBs and lumpy cost increases for customers in periods of high inflation, as we are currently in.

**Balance required**

We acknowledge that in the draft decision, the Commission is trading off the four objectives contained in the purpose section of the Commerce Act, which can be challenging in these uncertain times. Despite the uncertainties, it is vital that the correct balance is struck to ensure a successfully functioning sector for the next five years.

In paragraph 2.3 of the draft reasons paper, the Commission states that the expenditure allowances are set *"to reduce the risk to customers that EDBs forecasts may be too high, or overly ambitious to deliver"*. By setting lower allowances, the Commission is seeking to ensure that customers do not face unnecessarily high prices over the regulatory period.

But there is also a risk of setting the allowances too low.

The Commission states in paragraph 2.7 in the draft reasons paper that *"a material uplift in investment is needed for network solutions to provide additional capacity"*. Orion has significant concerns that the allowances provided for in this decision will not allow for this uplift in investment.

Insufficient allowances prevent EDBs from undertaking the necessary investment in their networks to ensure that they can deliver a safe and reliable service to customers that will support future services. With insufficient allowances, EDBs will need to make difficult trade-offs between maintaining their existing network, improving the network's resilience and providing for new connections. While customers do not want unnecessary cost increases, they also want a network that provides reliable and resilient electricity and provides for new connections in a timely manner.

While the Commission has provided for an increase in allowances, the proposed increase is unlikely to be sufficient to create a material uplift in investment, particularly once interest rates, inflation and other costs are taken into account.

It is also important to note that using an average across the regulatory period can lead to a need to actually reduce annual investment at the start of a regulatory period, if investment levels have increased throughout the previous regulatory period. This could necessitate reducing activity levels and demobilising crews in the early years of DPP4, which (all else being equal) is inefficient and

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[2] Environment Canterbury - From our Chair: What's behind proposed rates rises | Environment Canterbury (ecan.govt.nz)

could create future deliverability issues. We expect that this will be the experience of a number of EDBs.

**Deliverability of capex programmes**

The Commission notes in the draft reasons paper that it is not convinced that EDBs will be able to complete their proposed capex programmes and that this has influenced the allowances that have been provided.

We remain confident that our proposed capex spend is appropriate, necessary and achievable to be able to meet the needs of our customers and region. Our forecasts are informed by discussions with our service providers and ensuring that we have sufficient internal capability to enable successful delivery of our proposed capex spend.

**Current allowances are not in the best interests of customers**

Orion submits that the Commission should relook at the DPP4 capex allowances to provide EDBs sufficient scope of investment and flexibility to adequately serve their customers and to meet the purposes of the Commerce Act.

For many EDBs, the current allowances fail to ensure that suppliers have incentives to innovate and to invest in replacement, upgraded and new assets (Section 52A(1(a)) or improve efficiency and provide services at a quality that reflects consumer demands (Section 52A(1)(b)), as neither of these can be achieved without sufficient capex allowances. EDBs will also struggle to achieve the no material deterioration principle if they have insufficient capex allowances to invest in their networks.

**Implications of capital contributions decision**

The Commission is proposing a significant change to the capex allowance calculation from DPP3, by adjusting for forecast capital contributions.

Orion acknowledges that this adjustment is seeking to account for changes in connection charge regimes, but this adjustment fails to recognise the uncertainties around future connection volumes, while having a material impact on an EDBs allowances.

As the Commission acknowledges throughout the draft reasons paper, there are a number of uncertainties in the DPP4 regulatory period, particularly around the impact of and speed of the electrification of the economy. In many cases, new connections are driven by the customers and the economic conditions that they face, rather than being something that EDBs can directly control. There have already been a number of significant changes in the last year which will have an impact on the number of new connections that take place e.g. the removal of the GIDI fund.

Because of these changes, forecasts of connections are likely to be significantly different from what was forecast in the latest AMPs. If the contributions from these new connections do not eventuate,

including for customers no longer proceeding with or delaying projects, there will be minimal impact on the commissioned assets outcome, but the capex allowance has been reduced artificially.

Such a policy also creates unhelpful precedents for future DPP decisions. The proposed adjustment essentially penalises EDBs who have forecast significant growth in capital connections. If this decision is introduced, EDBs will be incentivised to minimise their forecast capital connections in the future to minimise the impact on their capex allowance in future periods. As a result, only certain contributions are likely to be included in future forecasts. We do not consider that this is the intent of this policy.

We believe that the Commission should reconsider this policy. We do consider that large scale non-reoccurring projects, which can distort an EDB allowance (both in terms of the gross capex in the historic reference period, and the reduction of the allowance in the forecast period), should not be included in the setting of allowances. Any changes that are due to material changes in capital contributions policies could be captured and accounted for, as part of the additional reporting considered in paragraph B252 of the draft reasons paper.

If the Commission wishes to continue with this proposal, we submit that EDBs should have the opportunity to revise their capex and contributions estimates to ensure that it best reflects the current environment. This is consistent with decisions made elsewhere in the draft DPP4 decision where the Commission is seeking to use the most up to date information in setting the regulatory regime for the DPP4 regulatory period.

The draft reasons paper discusses an intent to consider future additional reporting on capital contribution policies in paragraph B148. We note that the Electricity Authority is also considering capital contributions as an area of interest in its current work on distribution pricing reform. It is important that the two agencies are aligned in their work in this space and, if the Authority makes any changes, that consequential changes are made to the DPP4 settings using Commerce Act Section 54V provisions, if required.

**Limitations of flexibility mechanisms**

Throughout the reasons paper, the Commission notes that EDBs can use reopeners and/or apply for a Customised Price Path if the default settings in DPP4 are not appropriate. But these mechanisms have both time and cost implications associated with them, which must be recognised. Both mechanisms require time and resources from both EDBs and the Commission to prepare and process. Ultimately, it is customers who face the cost of this process (including the added cost of any inefficiencies in the processes), and who bear any delay.

The draft reasons paper notes that the DPP process is designed to be a low cost approach to regulating EDBs and that EDBs can seek a CPP if it does not meet their situation and requirements. However, it is important to note that a CPP application is a multi-year process and, unless a CPP application is already underway, it provides no certainty to EDBs until the middle of the regulatory period. In the meantime, EDBs need to work within the allowances set in the DPP. It is therefore essential that the DPP best meets the needs of EDBs throughout the period, regardless of whether some EDBs will subsequently choose to seek a CPP.

**Improved guidance on reopeners**

Orion supports the Big6 submission on reopener guidance. Additional comments are made below.

Orion supports the commentary around measures to improve the efficiency of the reopener process including the preparation of clear guidance on reopener applications. Having clarity and regulatory certainty about what is expected in these applications enables EDBs to prepare the applications in an efficient manner (avoiding unnecessary costs to customers). It also minimises the time and effort required from the Commission in processing applications by ensuring that they are fit for purpose, contain the appropriate information and meet the requirements.

In particular, we encourage the Commission to provide guidance on how it will consider reopener applications for EDBs whose work programme has had to be scaled back due to capex allowances. In the draft reasons paper, it is suggested that EDBs prepare a prioritised list of projects that they intend to undertake with their capex allowances.

Fundamentally, Orion has concerns about whether it is appropriate within the DPP regime for the Commission to be making assessments of EDBs spending within their allowances. This regime is based on EDBs receiving set allowances and having the discretion around how these are spent. There is a risk that this is undermined if the Commission is going to be making assessments about the appropriateness of EDBs' prioritisation decisions within their allowances.

Regardless, it is vital that EDBs have clarity around how reopeners will be assessed, including if/how the Commission will decide whether particular projects should have been prioritised within existing allowances or not (and what bearing that will have on any subsequent reopener applications). It is critical that this information is provided before the start of DPP4 to enable EDBs to appropriately prioritise their capex allowances.

**Five year historical reference period**

Orion considers that the proposed five year reference period for setting capex allowances is preferrable to the seven year reference period used in DPP3. We believe this reflects the changing nature of this expenditure as the sector evolves and addresses the need for increased resilience and supports customers future energy choices.

**Do not support the level of industry specific inflation uplift**

Orion has prepared a separate, joint submission with Wellington Electricity and Vector covering our views on draft decision C6 in detail.

In summary, Orion does not consider that the Commission's draft decision to utilise All-Groups CGPI + 0.8% to escalate capex allowances is appropriate. As discussed in our joint submission, a 3.1% uplift would have a range of benefits, including better reflecting long term averaging and supporting regulatory certainty.

## Operating expenditure (opex)

### 2. Opex

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|---|---|
| *O1.1* | *Apply a base-step-trend approach to forecasting opex.* |
| *O1.2* | *Use 2024 as the base year. [2024 AMP forecasts used for the draft decision]* |

*View/Response:*

Orion supports the continued use of the base-step-trend approach and the use of RY24 as the base year.

Orion also notes the proposed amendments to the Electricity (Hazards from Trees) Regulations 2003, which are expected to be gazetted later this year. We agree with footnote 266 in the draft reason paper that if these changes are implemented, they should be reflected in the final DPP4 decisions.

### 3. Opex step changes

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| *O2.1* | *Consider proposed step-changes against a defined set of factors, incorporating judgement.* |
| *O2.2* | *Step-changes should be significant.* |
| *O2.3* | *Step-changes should be adequately justified with reasonable evidence in the circumstances.* |
| *O2.4* | *Step-changes must not be included elsewhere in expenditure allowances.* |
| *O2.5* | *Step-changes should have a driver outside the control of a prudent and efficient supplier.* |
| *O2.6* | *Step-changes should be widely applicable.* |
| *O3.1* | *Include a step-change to reflect increasing insurance costs.* |
| *O3.2* | *Include a step-change for greater consumer engagement.* |
| *O3.3* | *Include a step-change for low voltage (LV) monitoring and smart meter data.* |
| *O3.4* | *Include a step-change for increasing cyber-security costs.* |
| *O3.5* | *Include a step-change for the costs of software-as-a-service (SaaS).* |
| *O3.6* | *Include a negative step-change in Aurora’s indicative forecasts to capture the end of its CPP spend.* |
| *O3.7* | *Cap aggregate step-changes (in real terms) at 5% of trended opex excluding step-changes.* |

*View/Response:*

**Support the new step changes and change in assessment criteria…**

Orion supports the acceptance of the five proposed step changes, and the proposed changes in the assessment criteria.

The proposed changes to the criteria better enable the intent of the mechanism to be met, while recognising the practicalities facing EDBs. As the Commission noted in the draft reasons paper, the existing criteria were too rigid to provide the incentive that the Commission was looking for. We agree that the proposed changes to the criteria better capture the intent of the mechanism, while better reflecting the realities facing EDBs.

While Orion welcomes the proposed step change for insurance, we submit that the Commission should consider an alternative mechanism for the on-going treatment of insurance costs as they are likely to continue to increase at a rate that far exceeds the opex inflation rate, such as making it a pass through cost.

We note that the Commission has issued a notice of intent to amend the IMs in relation to insurance. We encourage the Commission to consider the most appropriate way to recognise the increasing cost of insurance to EDBs (while ensuring that they are incentivised to maintain appropriate levels of insurance cover).

**… but do not support the aggregate cap**

But Orion does not support the proposed cap on the aggregate step changes at 5% of trended opex (draft decision O3.7).

In the draft reasons paper, the Commission states that step changes should have appropriate scrutiny before approval and that if the step changes are too big, that these should receive additional scrutiny through a CPP.

We submit to the Commission that, by definition, the step changes are undergoing additional and appropriate scrutiny. Each step change must meet the assessment criteria which means that they are both justifiable and significant (amongst other matters). The step changes are also subject to commercial pressures, meaning that EDBs have limited ability to influence the costs they face. Further the Commission has received additional detailed information for these step changes that is over and above the normal level of detail required in a DPP.

With each of the step changes being unique, separate matters with different drivers, it is inappropriate to combine them together with a singular cap. If a particular step change meets the criteria, why is the EDB limited in its ability to claim this revenue because of other unrelated expenditure? This will create inconsistencies of treatment between EDBs depending on the number and size of step changes each EDB has received. It also creates perverse incentives on EDBs by limiting the very incentives that the Commission is seeking to create for EDBs to “sufficiently maintain and invest in their businesses and networks for the long term benefits of their customers” (as stated in paragraph C38) once an EDB has reached their step change aggregate cap.

Given that the step changes are, by definition, able to be justified, are significant and outside the control of the EDB, such a cap seems to be counter to the intent of this mechanism. If the Commission does consider that an aggregate cap is necessary, we would encourage the Commission to increase it to 10% which remains within what the Commission has considered to be a price shock historically, rather than the 5% that is currently proposed. Alternatively, a discrete 5% cap by each step change could be applied.

We note that this position differs to the position taken by the ENA.

## 4. Opex trend factors

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| *O4.1* | *Escalate all opex costs using the same cost escalator.* |
| *O4.2* | *Escalate opex using the all-industries labour cost (60% weighting) and a producers' price (40%) indices, plus a 0.3% uplift to reflect EDB-specific inflation.* |
| *O5.1* | *Scale growth forecast separately for network and non-network opex.* |
| *O5.2* | *Use 2018-2024 as the reference period for scale elasticities and driver projections [2024 data available post-draft].* |
| *O5.3* | *Forecast network opex scale growth with line length (elasticity 0.52) and ICPs (0.45).* |
| *O5.4* | *Forecast non-network opex scale growth with line length (elasticity 0.35), ICPs (0.22), capex (0.30).* |
| *O5.5* | *Forecast lines length extrapolated using recent growth rate trend, and irregular data adjusted.* |
| *O5.6* | *Forecast ICP count extrapolated using recent growth rate trend, and irregular data adjusted.* |
| *O5.7* | *Forecast capex based on a constant growth.* |
| *O6.1* | *Apply an opex partial productivity factor of 0%.* |

*View/Response:*

**Industry specific inflation uplift**

Orion supports the Commission's draft decision on opex escalators for non-network opex, but we do not agree with the proposed approach for network opex. Instead, we advocate for an approach that recognises non-labour inputs for network opex are more closely aligned to network capex non-labour inputs (rather than non-network opex non-labour inputs).

Orion has prepared a separate, joint submission with Wellington Electricity and Vector covering our views on draft decisions O4.1 and O4.2 and we refer you to that for more detail.

**Supports using 2024 data**

Orion supports using the most up to date information in the final determination (i.e. using information on 2024 in the reference period).

**Partial Productivity Factor**

Orion supports the draft decision to apply an opex partial productivity factor of 0% (Draft decision O6.1). Further detail on our position can be found in our March 2023 submission on the Cambridge Economic Policy Associates (CEPA) EDB productivity study.

## Innovation and section 54Q incentives

5. Innovation, energy efficiency and demand side management

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| *U1* | *Introduce an Innovation and Non-traditional Solutions Allowance (INTSA), capped at 0.6%.* |
| *U2* | *Incentivise energy efficiency and demand-side management incentives through the INTSA.* |
| *U3* | *Do not introduce a reduction of energy losses incentive.* |

*View/Response:*

**Generally, supports the changes to the INTSA scheme**

Orion welcomes the proposed changes to the INTSA scheme and expects that the proposed changes will incentivise EDBs to undertake additional innovation projects. We support the release of guidance and a voluntary template to support EDBs to apply for INTSA projects in an efficient manner.

Orion is encouraged by the increase in the allowance to 0.6% of maximum allowable revenue. The higher allowance will foster greater innovation to occur across the regulatory period. However, we submit that the Commission should provide EDBs with the opportunity to access allowances up to 5% of their maximum allowable revenue. Providing for a higher allowance will incentivise EDBs to be innovative, utilise non-traditional solutions when feasible and encourage EDBs to be ambitious for the development of such projects.

A higher allowance will ensure that EDBs are not constrained when they have appropriate projects throughout the regulatory period, while the criteria and approval process will mean that EDBs cannot use this allowance inappropriately. If EDBs do not have appropriate projects, they will not be able to access the full amount of funding.

Orion supports the Commission's intent to prepare published guidance to minimise the administrative burden for EDBs. Clear guidance will support EDBs to prepare applications and reduce the cost of doing so. We would encourage the Commission to be clear in this guidance what costs are able to be captured in the INTSA allowance. It is important that the Commission enables a sufficiently broad range of costs to be captured to ensure that EDBs are incentivised to undertake INTSA projects.

The move from an ex post to an ex ante approval scheme will provide much needed certainty for EDBs who are considering undertaking INTSA projects. We consider that this is a beneficial change. However, it will be important that such a scheme is well-managed and provides the correct incentives to EDBs. For example, we consider that there should be a mechanism which enables EDBs to apply for an increase in budget for a project throughout the project. While we appreciate that the Commission is seeking to make this a streamlined process, without a mechanism to reassess costs, EDBs will be incentivised to create significant buffers within their project budgets to account for possible cost escalation or contingency, especially in multi-year projects. Such a mechanism could only be enabled for projects where cost escalation has exceeded a particular threshold to reduce the number of reassessments that need to be undertaken and/or the Commission could provide guidance of appropriate contingency percentages to apply to total project costs as is common in construction projects.

It will be important that EDBs can withhold commercially sensitive information for public release at the start of a project to avoid compromising their commercial position. We submit to the Commission that it would be preferrable if EDBs could withhold budget information for innovation projects where they are looking to enter commercial arrangements to avoid impacting on the EDBs' negotiating position for the project. This information could be disclosed in full to the Commission and potentially in aggregate in publicly released material. To do otherwise, could result in higher than necessary costs (which are ultimately borne by customers) for little benefit. The full budget could be disclosed in the subsequent close out report.

We also welcome the requirements to complete a close out report to enable others to learn from a project. We encourage the Commission to remain open minded to receiving similar applications from EDBs in different contexts and combinations through this mechanism. For example, trialing flexibility procurement with different technologies or for different reasons (e.g. congestion, localised lv voltage etc).

Orion would also welcome the opportunity for EDBs to use a proportion of their INSTA allowance to support collaboration between EDBs. For example, it would be beneficial if EDBs had the opportunity to contribute funding from their INTSA allowance to support the activities of the Electricity Networks Aotearoa (ENA) Future Networks Forum (FNF). The FNF identifies opportunities for EDBs to collaborate to create value for customers (with a particular focus on achieving climate change goals). We submit for the Commission to articulate their position on this point.

Collaboration through a network, such as the FNF, may not strictly meet the current INTSA criteria, particularly if it is not for a specific project. But we consider that funding general EDB collaboration around innovative and non-traditional solutions meets the intent of the INTSA scheme. We encourage the Commission to consider how this form of collaboration can be encouraged by the INTSA scheme.

The draft reasons paper states that director certification will be required to confirm that a project would not go ahead without support from the INTSA. While we appreciate the intent behind this proposal, it is unclear how this would work in practice. For example, if a project is certified as one that won't go ahead but the project is not approved as an INTSA project, does this mean that the EDB could not progress this project in the future? There may be a change in circumstances (e.g. funding becoming more favourable) which changes the EDBs position on the project. It would be disappointing if EDBs would no longer be able to progress a project because it had previously failed as an INTSA project.

Orion also has concerns about the requirement for projects to be riskier than business as usual. Risk profiles and the expected financial return can differ significantly between projects. In particular, innovation projects can have very different risk profiles to non-traditional solutions. It would be difficult in practice to demonstrate that projects are riskier than business as usual, resulting in some projects not proceeding. We support the suggestion in the ENA's submission that the criteria should instead refer to uncertain financial benefits.

Orion supports the new limits on the share of project expenditure able to be recovered from customers proposed in the draft reasons paper. We expect that these limits will encourage more INTSA projects to be undertaken. Enabling projects that are unlikely to have financial benefits for EDBs to be fully recovered from those who receive the benefits (i.e. customers) may provide an incentive for EDBs to consider more experimentation, trials and implementation of these types of projects.

## Quality

### 6. Quality standards

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| *QS1* | *Maintain separate standards for planned and unplanned SAIDI and SAIFI.* |
| *QS2* | *Retain annual unplanned reliability standards for SAIDI and SAIFI.* |
| *QS3* | *Retain the 2.0 standard deviation buffer for setting the unplanned interruptions reliability standards.* |
| *QS4* | *Maintain regulatory period length standard for planned SAIDI and SAIFI.* |
| *QS5* | *Change the planned reliability buffer for the planned interruptions reliability standard to be a 100% uplift on the historic average, capped at a +/- 10% movement from the current standard.* |
| *QS6* | *De-weight the impact of notified planned interruptions by 50% in the assessment of compliance with planned interruption standards.* |
| *QS7* | *Retain SAIDI extreme event standard set at 120 SAIDI minutes or 6,000,000 customer minutes where specified.* |
| *QS8* | *Retain enhanced automatic reporting following a breach of a quality standard.* |
| *QS9* | *No new quality measures are introduced as part of the quality standards applying in DPP4.* |
| *QS10* | *Set interruptions quality standards and incentives for Aurora transitioning from a CPP to the DPP on the same basis as for other EDBs on the DPP.* |
| *QS11* | *Retain the requirement for reasonable reallocation of SAIDI and SAIFI following an asset transfer between EDBs.* |

*View/Response:*

We support the ENA's submission on these matters, subject to the comments below.

### Notification incentives should be maintained

Orion has concerns that the Commission is considering changes to planned notification incentive. It would be inappropriate for the service reward within the SAIDI/SAIFI scheme to be used to set the SAIDI and SAIFI levels. In such a scheme, as EDBs do better with their customer service, it becomes harder and harder for them to meet the targets and limits. Orion considers that it is important that the incentives remain to continue to encourage EDBs to continue to notify customers but that this aspect should not then factor into SAIDI/SAIFI setting more broadly.

**Management of fire risk**

The draft reasons paper seeks feedback on how EDBs are managing fire risk in paragraph E437. Orion undertook a study in 2017 which looked at how fire risk was managed. This study sought to:

- Reduce the number of auto reclose attempts made by protection systems to 1 per fault; and
- Keep the single shot reclose dead time as low as reasonably practicable.

As an additional safety measure the study did not use auto reclosing in conjunction with a Ground Fault Neutraliser.

The impact on SAIDI and SAIFI was found to be negligible. Only 5% of auto reclose attempts successfully closed after 2 shots (i.e. 95% of those which trip after 1 shot are permanent faults).

Further, Orion has implemented targeted automation of recloser settings during fire season informed by weather and fire condition information.

**Accuracy of information**

We note that the information that the Commission has used in its draft decision model differs from the ID disclosure material that Orion has provided previously. The differences between the data that the Commission has used and our previously released information is provided below. We expect that the Commission will correct this information error in its final determination.

| Year | Planned SAIDI differences | Planned SAIFI differences |
|---|---|---|
| 2014 | 0.005 | 0.000 |
| 2015 | 0.000 | 0.000 |
| 2016 | 0.000 | 0.000 |
| 2017 | 0.000 | 0.000 |
| 2018 | 0.000 | 0.000 |
| 2019 | 0.000 | 0.000 |
| 2020 | 0.000 | 0.000 |
| 2021 | 1.134 | 0.000 |
| 2022 | 0.494 | 0.001 |
| 2023 | 2.169 | -0.002 |

**Importance of having sufficient allowances to support no material deterioration**

As a general point, Orion continues to submit that EDBs must be provided with sufficient revenue/expenditure allowances to be able to achieve the continued principle of no material deterioration. Without them, EDBs will struggle to undertake the necessary investment required to maintain and harden their networks and to avoid any deterioration of quality standards.

## 7. Quality Incentives

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| *QIS1* | *Retain the revenue-linked quality incentive scheme for planned and unplanned SAIDI. SAIFI is excluded.* |
| *QIS2* | *Unplanned incentive rates are informed by the value of lost load (VOLL), discounted by (1-IRIS retention factor) to reflect expenditure incentives, and a further 10% to reflect quality standard incentives, with VOLL set at $35,374r/MWh.* |
| *QIS3* | *Planned incentive rates are reduced by 35% relative to the unplanned incentive rate.* |
| *QIS4* | *Planned 'notified' interruptions are reduced by 75% relative to the unplanned incentive rate to reflect less inconvenience to customers.* |
| *QIS5* | *Incentives are revenue-neutral at the average of the reference period, also known as the target.* |
| *QIS6* | *The SAIDI caps (which determine maximum losses) are set equal to the SAIDI limits for planned and unplanned SAIDI.* |
| *QIS7* | *The SAIDI collars (which determine maximum gains) are set at 0 for unplanned and planned SAIDI.* |
| *QIS8* | *Cap revenue at risk at 2% of actual net allowable revenue.* |
| *QIS9* | *Do not implement any new incentive schemes.* |
| *QIS10* | *Do not make an explicit adjustment to match the duration of retention benefits between EDBs and customers.* |

*View/Response:*

Orion supports the position outlined in the ENA submission on these matters.

## 8. Normalisation

| | |
|---|---|
| *N1* | *Normalisation only applies to unplanned interruptions, which are the only initiators of a major event day.* |
| *N2* | *Retain the normalisation approach used in DPP3, being:*<br>- *define a major event as 24-hour rolling periods (assessed in 30-minute blocks)*<br>- *the major event boundary value has been identified as the 1104th highest rolling 24-hour period for SAIDI and SAIFI over the 10-year reference period*<br>- *normalisation is applied on half-hour blocks, within a major event, where the SAIDI figure exceeds 1/48th of the boundary value, and*<br>- *treat major events by replacing any half-hour that is greater than 1/48th of the boundary value with 1/48th of the boundary value if that half-hour is part of the major event (can exceed 24 hours in duration).* |

| | |
|---|---|
| *N3* | *SAIDI and SAIFI major events are triggered independently.* |
| *N4* | *Set a higher boundary for very small EDBs.* |
| *N5* | *Retain additional reporting by EDBs for each unplanned major event in its compliance statement consistent with DPP3.* |

*View/Response:*

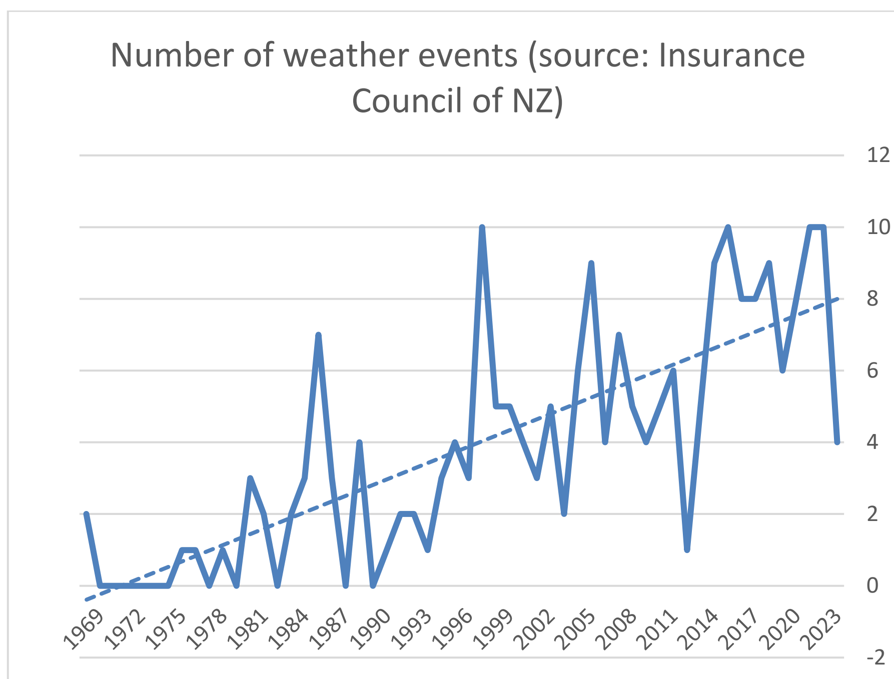
**Major event days (MEDs)**

In the draft reasons paper, the Commission concludes that there should be no change in the number of MEDs, based on the study by the IEEE. But it is clear that with climate change occurring around us, that weather patterns are already changing and we can expect that there will be more extreme events moving forward.

However, it is not only the frequency of major events that will impact on the ability of EDBs to achieve quality standards, but also the increasing frequency of smaller weather events which in aggregate could have an increasingly significant impact.

Data on the cost of insurance events in New Zealand shows a clear trend of increasing weather related events occurring each year.[3] Since 2013 there have been, on average, eight weather related events a year costing around $580m per annum. These events ranging from small scale floods and storms through to the recent Auckland Anniversary flooding and Cyclone Gabrielle. While not all of these would be significant enough to trigger the MED exemption, it suggests that 2.5 MED is low.

[3] Data sourced from the Insurance Council of New Zealand (https://www.icnz.org.nz/industry/cost-of-natural-disasters/) and subsequently cleaned to remove any events relating to earthquakes.




These storms, floods and cyclones all impact on the assets of EDBs and, even when the events are not big enough to be deemed a MED, will impact on the ability of EDBs to meet their quality standards, in aggregate. As climate change causes the number of events to increase, it will become increasingly important for the impact of the changing weather patterns to be considered.

## 9. Reference period

| | |
|---|---|
| *RP1* | *Use a 10-year reference period from 1 April 2013 to 31 March 2023 to inform the parameters for unplanned interruptions reliability standards and incentives, with the period adjusted to 1 April 2014 to 31 March 2024 for the final determination.* |
| *RP2* | *Apply a reference period for planned interruptions of 2017 – 2023 for the draft decision, extended to 2017 – 2024 for the final decision.* |
| *RP3* | *Retain the cap on inter-period movement, ±5% for unplanned interruptions for both the SAIDI and SAIFI unplanned target and also apply this to the SAIDI and SAIFI unplanned limits.* |
| *RP4* | *Make no explicit step changes to reliability targets or incentives.* |
| *RP5* | *Make no explicit adjustments for instances of non-compliance contained within the unplanned interruption reference period dataset.* |
| *RP6* | *EDBs must record successive interruptions on the same basis they employed in responding to the s 53ZD notice.* |

| RP7 | *Interruptions directly associated with an approved INTSA project are excluded for calculation of SAIDI and SAIFI values up to a cap of 0.5% of the respective SAIDI and SAIFI limit.* |
|---|---|

*View/Response:*

**Clarity sought around exclusion for the calculation of SAIDI and SAIFI for INTSA projects**

It is unclear from the draft reasons document whether the Commission intends for the exclusion of the interruptions associated with an approved INTSA project to be optional or compulsory.

For example, in paragraph D31.1.6 the reasons paper states:

> *"explain whether the EDB anticipates applying an automatic quality standards exclusion and, if so, what the cause or causes of the interruption are."*

But by comparison, paragraph E480 states:

> *"Our draft decision is to exclude outages directly associated with an approved innovation and non-traditional solutions allowance (INTSA) project from the calculation of SAIDI and SAIFI values up to a cap of 0.5% of the respective SAIDI and SAIFI limits".*

This inconsistency will need to be resolved in the final determination.

Orion submits to the Commission that it is most appropriate for EDBs to have choice over whether to seek an exclusion or not.

As noted in the draft reasons paper, INTSA projects may include a range of potential non-traditional and innovative solutions. There may be some projects where EDBs consider that it is preferable not to seek an exclusion to the SAIDI and SAIFI limits. For example, this could include projects where it is difficult to identify which interruptions are related to an approved INTSA project, or where the likely impact on the SAIDI and SAIFI limits are expected to be minor. EDBs are best placed to be able to make this decision.

Providing this flexibility to EDBs should not discourage the innovation that the Commission is wishing to provide. EDBs would retain the option to seek this exemption when it makes sense to do so and would not need to use it if it doesn't make sense for the business. In fact, requiring EDBs to identify the interruptions associated with an INTSA project may actually discourage EDBs from undertaking the project if, for example, recording the interruptions associated the project was costly and/or complex.

In addition to this, it is also unclear whether the Commission intends for this exclusion to only cover interruptions for ICPs directly involved in the project, or whether it is any interruptions associated with the project. For example, if interruptions occur from work required on an INTSA approved project that affect both ICPs associated with the project and ICPs who aren't, does the exclusion apply to all of the interruptions or only to those who are involved in the project. We submit to the Commission that all affected ICPs should be able to be excluded, regardless of whether they are directly participating in the INTSA projects or not.

## Revenue path

### 10. Price path

| | |
|---|---|
| P1 | *Set starting prices based on the current and projected profitability of each supplier using a building blocks allowable revenue (BBAR) model.* |
| P2 | *Set a default rate of change relative to CPI (X-factor) of 0%.* |
| P3 | *Set alternative X-factors such that, in most cases, initial price shock is limited to 20% in real per ICP. terms, and the change between years within the regulatory period to 10% (based on the price shock and notional financeability assessments).* |
| P4 | *Assess price shocks on a real revenue per ICP basis, incorporating wash-ups and IRIS.* |
| P5 | *Assess notional financeability using FFO/Debt and Debt/EBITDA ratios.* |

*View/Response:*

**Support full in-period revenue**

Orion supports the decision to allow full recovery of forecast allowable revenues within the regulatory period.

**$P_0$ adjustment vs X-factor**

For the first time, the Commission is currently proposing to smooth the necessary revenue increases across the regulatory period to manage consumer price shocks. While we acknowledge what the Commission is attempting to do, we consider that customers should face more of the cost in the first half of the period (and consequently smaller increases in the latter years).

With a higher $P_0$ and lower X-factors, customers will face a bigger initial shock, but lower shocks in subsequent years. This would also avoid the higher allowance revenue in the final years, reducing the risk of needing a more significant step change in revenues between DPP4 and DPP5.

Such an approach is supported by economic research by Nobel Prize winning economist, Richard Thaler, who found that where possible, customers would prefer to integrate their losses into a singular payment[4]. This research shows that when faced with a large cost increase, customers will have temporarily inelastic demand for additional costs. Smoothing more of the cost to latter years, when the customers demand elasticity has been restored creates increased perceived pain for customers, even when the total cost impact does not change.

The current proposed approach of lower starting revenue and higher X-factor will also have negative implications for EDBs in the first few years of the period, after already having to carry additional costs due to the higher than expected inflation in the latter years of DDP3.

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[4] Thaler, R (1985) "Mental Accounting and Consumer Choice" *Marketing Science* Vol. 4, No 3 (summer 1985), pp. 199-214.

The Commission notes that EDBs can apply for a CPP if the default DPP4 path is not suitable for their business. But, due to the time it takes to prepare and then process a CPP application, this will not assist in the early years of the DPP period.

We submit that additional relief should be provided to EDBs in the early years of the period. If the Commission is not willing to increase the starting revenue, it could consider implementing a variable X-factor as it has provided to Transpower. This would enable larger increases in the early years of the period followed by smaller increases later on. Such an approach would give EDBs time to seek to offset the smaller increases in latter years through the use of reopener applications or the preparation of a CPP application.

We also consider that if the Commission decides to smooth revenue between regulatory periods, that this sets a precedent and should occur between future regulatory periods, symmetrically. That is, that revenue smoothing should take place between all regulatory periods regardless of whether revenues are increasing or decreasing.

**Interaction between smoothing and CPP applications**

It is unclear though how the smoothing approach outlined in the draft decision interacts with any potential CPP applications. Given that allowances are essentially moved from the start of the period to later in the period, it will be important that these deferred allowances are accounted for in any subsequent CPP applications.

### 11. IRIS

| | |
|---|---|
| *I1* | *IRIS retention rate for capex is equivalent to the opex rate.* |
| *I2* | *Determine IRIS opex and capex forecasts in real terms (inflated by CPI).* |

*View/Response:*

Orion supports the position outlined in the ENA submission on these matters.

### 12. Revenue path

| | |
|---|---|
| *R1.1* | *Apply a revenue cap with wash-up as the form of control.* |
| *R1.2* | *Forecast CPI based on the four-quarter average change in CPI between the first year of the regulatory period and the current year.* |
| *R1.3* | *Apply a 90% "voluntary undercharging" limit (or an alternative in some cases).* |
| *R1.4* | *Include a large connection contract (LCC) wash-up term in the wash-up accrual formula, to avoid recovery of LCC revenue from other customers.* |
| *R1.5* | *Allow distributors to agree a reasonable reallocation of revenue following an asset transfer.* |
| *R2.1* | *Apply the revenue smoothing limit based on forecast net allowable revenue for the current year and CPI-adjusted recoverable costs from the prior year.* |
| *R2.2* | *Apply a revenue smoothing limit of 10%.* |

| | |
|---|---|
| *R3.1* | *Implement the revenue wash-up by specifying a re-run of the DPP4 financial model.* |
| *R3.2* | *Calculate the Y1 inflation wash-up based on the four-quarter average change in inflation between Y0 and Y1.* |
| *R3.3* | *Do not specify base revenue wash-up draw down amounts for DPP4.* |
| *R3.4* | *Calculate the time-value of money of the opening wash-up balance using one year of the DPP3 WACC and one year of a blended DPP3/DPP4 WACC (for a value of 5.25%). [This will be updated for the final decision.]* |

*View/Response:*

**Lack of clarity around calculation of wash up balances**

Orion seeks further clarity in the DPP4 decision documents around the wash up calculation, particularly for the first year of the period.

While we acknowledge that the calculation of the wash ups is covered in the Input Methodologies, it would be beneficial to include explicit calculations in the DPP4 documentation to assist EDBs to meet the requirements. Similar calculations were clearly laid out in the DPP3 determination and we consider that there is benefit in the Commission providing similarly clear calculations to assist EDBs to appropriately calculate their wash-up balances.

There is also a lack of clarity in the documents around how the wash-up draw down balance for the first year are to be calculated. While we expect that the Commission is intending that wash up balances are calculated from information from two years earlier, as has been general practice, it is critical that this is set out in the decision-making documents.

Similarly, it is difficult to understand from the new IMs and the draft DPP4 material how EDBs should calculate the wash-up draw down amounts in the fifth assessment period for DPP3. Orion encourages the Commission to provide further clarity within the DPP4 decision documents around how wash-up draw down amounts should be calculated, particularly across regulatory periods. While this is covered in clause 3.1.4(5)(b) of the IMs, it is not clear how this is intended to be implemented in practice as the clause suggests the amount to be drawn down by the EDB will be specified in the DPP determination, which we cannot clearly see. We understand that the Commission may have intended to provide discretion to EDBs around how they achieve this, but as it currently stands there is insufficient clarity for EDBs to ensure that they are complying with the determinations.

## 13. Other matters

| | |
|---|---|
| *X1* | *Retain the current five-year regulatory period length.* |
| *X2* | *Include Aurora in the DPP4 expenditure and revenue setting process.* |
| *X3* | *Retain the CPP application timings set for DPP3.* |

*View/Response:*

**Five year regulatory period provides regulatory certainty**

Orion supports the retention of the five year regulatory period. While there are uncertainties surrounding the period, these are more than offset by the benefits of providing regulatory certainty.

**Timing of CPP applications**

Orion supports retaining the CPP application timings set for DPP3. We acknowledge that it is important that there is sufficient time to appropriately consider the applications. However, as discussed earlier, the length of time that it takes to prepare and assess a CPP application can create significant issues for EDBs.

As the Commission refers to throughout the reasons paper, the DPP sets out a low cost price-quality path for all EDBs and those who do not consider that this path suits their situation can apply for a CPP. But as a CPP takes at least two years to prepare and be assessed, EDBs who find that the new DPP decision does not suit their situation are, by definition, subject to it for nearly half of the regulatory period.

## 14. Other inputs to the financial model

| | |
|---|---|
| *M1* | *Weighted average cost of capital (WACC) of 7.37%. [This will be updated for the final decision.]* |
| *M2* | *Include an allowance for disposed assets, based on historical levels.* |
| *M3* | *Forecast depreciation on existing assets based on information provided by each EDB.* |
| *M4* | *Use base year data from 2024 Information Disclosures in our final decisions, and data from 2023 Information Disclosures for our draft decisions.* |
| *M5* | *For CPI forecasts, use the most recently available RBNZ MPS forecasts from when the WACC was determined.* |

*View/Response:*

Orion supports the position outlined in the ENA submission on these matters.