

15 November 2021

Dayle Paris
Orion New Zealand Limited
565 Wairakei Road
Christchurch 8053

Dear Dayle

Orion Innovation Project Allowance Application—June 2021

Thank you for your June 2021 application on behalf of Orion New Zealand Limited (**Orion**) to draw down an amount from Orion's innovation project allowance under the *Electricity Distribution Business Default Price-Quality Path 2020 (DPP3)* to recover certain costs to be incurred in a carbon emissions offsetting project (**offsets project**).¹

Innovation in electricity distribution is essential, particularly in the current changing landscape with opportunities from new technologies as well as new challenges from decarbonisation. We appreciate Orion's interest in the innovation project allowance and acknowledge the efforts Orion is making to play a role in decarbonisation. We welcome further enquiries about the allowance mechanism from Orion and other EDBs.

We note that DPP3 only allows for approval of costs as recoverable under the innovation project allowance *after* an EDB has incurred them, not before.² As most of the expenditure on the offsets project is yet to occur, we cannot approve a drawdown amount from the innovation project allowance at this time, but we can provide a non-binding view on the likely outcome if Orion were to apply to us after incurring the expenditure.

Our non-binding view is that we would be unlikely to approve a drawdown amount for the offsets project because at this stage we consider that voluntary carbon offsetting falls outside the regulated electricity lines service (**ELS**) defined under s 54C of the Commerce Act 1986 (**Act**). This also means that the costs of the offsets project should not be included in the regulated asset base if it goes ahead without access to the innovative project allowance.

¹ Schedule 5.3 of [DPP3](#) enables an electricity distribution business (**EDB**) to apply to us for approval to drawdown an amount of up to 50% of its expenditure on an innovative project as a recoverable cost, up to an individual cap (the innovation project allowance) specified in Schedule 5.3 for the EDB.

² Paragraph (2)(b) of Schedule 5.3 of DPP3.

We also consider the offsets project would be unlikely to be sufficiently innovative to meet the definition of ‘innovation project’ under the *Electricity Distribution Services Input Methodologies Determination 2012 (IMs)*.

We provide more detail on our reasoning behind these views below.

An innovation project must relate to electricity lines services

Under Part 4 of the Act, DPP3 regulates a non-exempt EDB’s expenditure on assets used, or costs incurred, in whole or in part for supplying the regulated service—ELS. The innovation project allowance is a part of the DPP3 regime and is therefore intended to cover only regulated expenditure, ie, for the supply of ELS.

Our current position is that voluntary carbon offsetting—either through the purchase and cancellation of tradeable offsets or by the creation and cancellation of offsets (eg, through forestry)—falls outside the supply of ELS and is therefore a separate service. By ‘voluntary offsetting’ we mean offsetting that is not required by law under the New Zealand Emissions Trading Scheme (ETS) or other regulations.

This expenditure is unlikely to meet the definition of an innovation project

If voluntary carbon offsetting was, hypothetically, ELS, we would be unlikely to consider that the offsets project sufficiently innovative to meet the IMs’ definition of ‘innovation project’ and be eligible for the innovative project allowance.³

Orion contends the offsets project is innovative because Orion appears to be the only EDB intending to use this combination of mechanisms—verified emission reduction credits, forestry, and New Zealand Units—to offset carbon emissions and manage the risk of carbon offsetting price rises.

We note that Orion’s application only covers the cost of forestry planting, not purchasing carbon emissions credits. However, both of these practices are well-established approaches to offsetting carbon emissions. While adopting and adapting a technology or approach from a different sector for an EDB might be innovative in some instances, we do not consider carbon offsetting through forestry meets the definition of ‘innovation project’ because it is a widespread practice across many sectors and does not require specific adaptation to the electricity distribution sector.

³ Clause 1.1.4(2) of the [IMs](#) defines “innovation project” as “a project that is focussed on the creation, development or application of a new or improved technology, process, or approach in respect of the provision of electricity lines services in New Zealand.”

Feedback on the innovation project allowance mechanism

We note that Orion has raised several points regarding the design and operation of the innovation project allowance mechanism, particularly the requirement for the application to be made after an EDB incurs expenditure. While we must apply the mechanism in its current form, we appreciate this feedback and suggest that Orion makes these points in submissions on the upcoming IM review and the next DPP reset.

We would like to thank Orion for engaging early on this application. Innovation in the sector is vital, and we hope to see more applications in future. We will try to continue to provide indicative views when requested prior to formal applications being made.

Yours sincerely



Andy Burgess
Head of Energy, Airports, and Dairy Regulation