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Dear Dane

## **Feedback on the Input Methodologies ‘Draft Framework Review’ and ‘Process and Issues’ Papers**

### **Introduction**

1. The Commission published the ‘Part 4 IM Review 2023 Draft Framework paper’<sup>1</sup> and ‘Process and Issues Paper’<sup>2</sup> on 20 May 2022. The purpose of the papers is to consult on the proposed framework in reaching decisions on the input methodologies, inviting submissions on the framework by 11 July 2022.
2. Orion would like to thank the Commerce Commission for inviting submissions for the Input Methodologies (IM).
3. The purpose of IMs, set out in section 52R of the Act, is to promote certainty for suppliers and consumers in relation to the rules, requirements and processes applying to Part 4 Regulation.

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<sup>1</sup> [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0030/283863/Part-4-Input-Methodologies-Review-2023-Draft-Framework-paper-20-May-2022.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0030/283863/Part-4-Input-Methodologies-Review-2023-Draft-Framework-paper-20-May-2022.pdf)

<sup>2</sup> [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0031/283864/Part-4-Input-Methodologies-Review-2023-Process-and-Issues-paper-20-May-2022.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0031/283864/Part-4-Input-Methodologies-Review-2023-Process-and-Issues-paper-20-May-2022.pdf)

4. The context of the IM's is to satisfy Part 4 of the Commerce Act 1986 (Act) for price quality of goods or services in markets where there is little or no competition and, at the same time promoting the long-term benefit of consumers of those good and services.

## Summary

5. Orion welcomes the engagement by the Commission to seek feedback on the IM framework which are the upfront rules, processes and requirements of Part 4 regulation. IMs are used in setting the Information Disclosure (ID) and Price Quality (PQ) regulatory determinations.
6. This submission presents Orion's context, what has changed since the last review, what it means for us and other lines businesses and the key areas of focus for us on the Draft Framework and Issue and Process papers.
7. Annexure A provides targeted responses to the questions posed by the Commission in the Process and Issues Paper.

## Orion Context

8. Orion's purpose is 'Powering a cleaner and brighter future for our communities'<sup>3</sup> encapsulating the contribution we want to make to our community's future wellbeing and prosperity.
9. Our Group Strategy is focussed on five themes to fulfil our Purpose and deliver the Impacts we aim to make:
  - Re-imagining the Future Network – ensuring our network provides the services our customers need in a changing energy landscape
  - Customer Inspired – enabling the choices our customers make
  - Lead and Grow – being a forerunner in our field by providing strategic infrastructure leadership
  - Accelerating Capability – ensuring our Group and our sector can respond to the challenges ahead
  - Powering the Low Carbon Economy – being a proactive enabler of those seeking help to reduce their carbon footprint.
10. Orion's commitment to sustainability includes, remaining open to using innovative ways to achieve sustainable outcomes and aspiring to be a leader for sustainability<sup>4</sup>.

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<sup>3</sup> Page 5, <https://www.oriongroup.co.nz/assets/Company/Submissions/Orion-Feedback-on-ComCom-Open-Letter-priorities-for-energy-networks-2021-Final.pdf>

<sup>4</sup> <https://www.oriongroup.co.nz/corporate/our-sustainability-commitment/>

## Other Feedback

11. We support the feedback from the Electricity Network's Association on the IM review.

## Key areas of focus regarding the Draft Framework paper

Orion considers the following as key priorities for the Framework Review:

12. The industry is changing, driven, amongst other things, by customer demands and several economic challenges since the last IM review. We therefore see this as a timely review before setting DPP4.
13. Orion supports the overarching objects of the IM review, which includes significantly **reducing compliance costs**, other regulatory costs, or complexity (without detrimentally affecting the promotion of the section 52A purpose). Meeting our increased compliance obligations has an impact on productivity levels.
14. We would like to see more **efficient and flexible mechanisms** implemented to achieve better outcomes for consumers going forward.
15. Orion agrees that suppliers are best placed to **manage the costs associated with the risks** if they eventuate. There needs to be some level of certainty that the investment suppliers make is in the best interest for consumers and the regulated business.
16. **Aligning the IM's with the TCFD framework** makes sense given the focus on climate related risks and opportunities. We would like to emphasise that the Commission considers carefully whether this will place additional regulatory and audit burdens on regulated businesses.
17. **Face-to-face consultation and collaborative engagement** with the Commission. While we appreciate we have faced challenges in meeting in person due to COVID, we believe that ongoing dialogue and face to face engagement will give better context to the challenges we face going forward.

## Key areas of focus regarding flexibility in the regulations in the Process and Issues paper

Orion considers the following as key priorities for this IM Review:

18. **The concept of dynamic regulation** is needed, as defined by the CEER<sup>5</sup>. This is a regulatory approach that is limited in time, focussed on the energy sector activities it covers and/or the energy sector participants who can participate, and which aims to cope with novelty in the energy system with the goal of informing future regulatory decision-making through experimentation.
19. We need dynamic regulation to address the fundamental change in the energy system.

These changes include new or changing expectations and responsiveness needed for:

- Climate Change
- Preparing the community for adverse events in line with our lifeline utility role
- Changing use of the energy system and consumer expectations
- New technologies and the need to innovate
- The requirement for new systems and business models.

We note the Commission's comment regarding uncertainty under point 4.14.4, like reopeners being more dynamic and streamlined. The articulation of the challenges of uncertainty in the UK and mechanisms for dealing with this are detailed in Ofgem's' Business Plan 2023-2028 for RIIO-ED2<sup>6</sup>. While we appreciate we may lag in the adoption of DER in New Zealand, it would be prudent to approach our sector's future challenges in a similar manner.

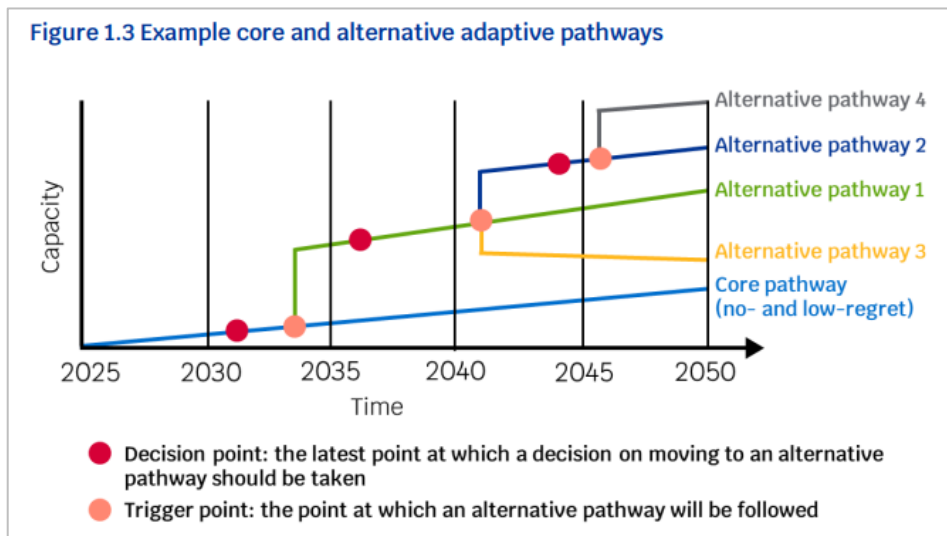
Water has several challenges over the next 30 years similar to the electricity industry. Ofwat has identified in-period trigger points in the diagram below to consider important shifts and changes. We see the IM Review that the Commission undertakes as one of these key points in time. Their approach is to have a core pathway which can be adapted over time to a more appropriate alternative pathway as context and information becomes clearer. See Page 7 of Ofwat's guidance on long term delivery strategies<sup>7</sup>

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<sup>5</sup> <https://www.ceer.eu/ceer-approach-to-more-dynamic-regulation#>

<sup>6</sup> [https://d16qag4vfpk8c6.cloudfront.net/app/uploads/2021/12/UKPN-RIIO-ED2-Plan-Ofgem-Updated-INTERACTIVE\\_Final.pdf](https://d16qag4vfpk8c6.cloudfront.net/app/uploads/2021/12/UKPN-RIIO-ED2-Plan-Ofgem-Updated-INTERACTIVE_Final.pdf)

<sup>7</sup> [https://www.ofwat.gov.uk/wp-content/uploads/2022/04/PR24-and-beyond-Final-guidance-on-long-term-delivery-strategies\\_Pr24.pdf](https://www.ofwat.gov.uk/wp-content/uploads/2022/04/PR24-and-beyond-Final-guidance-on-long-term-delivery-strategies_Pr24.pdf)



**Figure 1: Ofwat's guidance on long term delivery strategies.**

19.1 Innovation mechanisms - we need mechanisms, intra-regulatory period, to be more flexible in our approach to consumer demands going forward and adapt to the changing environment in which we will be operating.

19.2 Flexible Reopeners - We are experiencing escalating costs and supply chain delays. This has caused an immediate issue for EDBs under the current regulatory settings which will extend to addressing climate change related adaptation. Reopeners need to take account of both Opex and Capex.

20. **A Totex approach to expenditure** - The current choices we face to substitute Capital Expenditure (e.g. in-house software or infrastructure build) with Operational Expenditure (e.g. cloud-based services or flexibility services) is one example of the need for expenditure flexibility. This, coupled with rising costs, requires flexibility to allocate costs between Capex and Opex to ensure better outcomes for customers. IRIS is a challenging incentive in this space.

21. **Forward looking approach to setting Opex and Capex**- the fast changing and complex environment in which we now operate means past expenditure is not a good gauge for future expenditure and it is prudent to take a more predictive approach to ensure customers continue to be served appropriately.

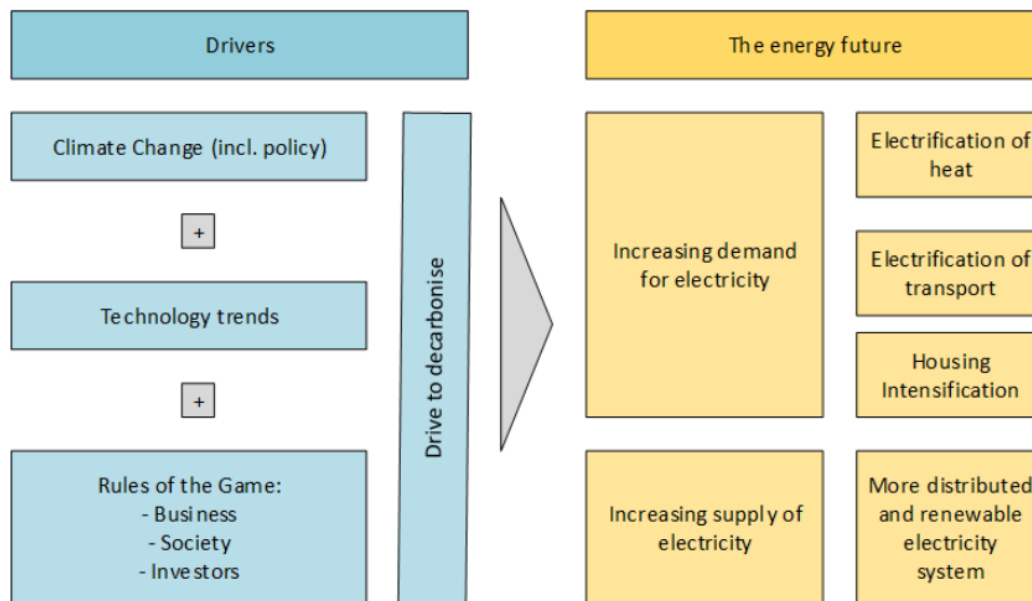
22. **Risk exposure of self-insurance** and the impact this may have on rising debt levels. We urge the Commission to undertake an assessment of self-insured assets as a part of the scope of the confidential debt survey that the Commission has indicated it will undertake during the IM Review. We would like the Commission to consider a form of re-opener for more severe but not catastrophic events as weather events become more frequent.
23. **Resilience to climate change**- Current government policies have placed more emphasis on climate change with regulations aiming to provide for the best outcomes for consumers and regulatory rules need to reflect this. In other jurisdictions like the UK, Ofgem released their RIIO-ED2 Business Plan 2023 – 2028, “**Placing customers and communities at the heart of Net Zero**”<sup>8</sup>. In Chapter 16, Ofgem have developed a framework for managing uncertainties of distributed energy futures. Ofgem also makes it their ambition that: *“We will make our networks ready to accommodate low carbon technologies, and we will facilitate this transition. We will do this in a way that protects customers from higher costs over RIIO-ED2, while maximising the scope for customer participation through flexibility.”* Their collaborative approach provides flexibility for addressing resilience between the regulators, regulated businesses and consumers to address the localised, complex and sometimes uncertain impacts, until data and information insights become clearer, for particular regions.

### **Our challenges are different than the last IM Review**

24. When the last IM Review commenced in 2016 the market for EDBs was one of a ‘death spiral’ raising concern of stranded assets.
25. The landscape we find ourselves in for this review is at 180 degrees to 2016. Electricity is now a key national enabler for decarbonisation driven by a climate emergency and New Zealand’s international commitments for net zero carbon. We are in a paradigm shift compared to 2016. The following diagram provides a high-level summary of this our current context.

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<sup>8</sup> [https://d16qag4vfpk8c6.cloudfront.net/app/uploads/2021/12/UKPN-RIIO-ED2-Plan-Ofgem-Updated-INTERACTIVE\\_Final.pdf](https://d16qag4vfpk8c6.cloudfront.net/app/uploads/2021/12/UKPN-RIIO-ED2-Plan-Ofgem-Updated-INTERACTIVE_Final.pdf)



**Figure 2: Current drivers of change facing the electricity industry**

26. The Commission needs to take an energy centric view on energy usage. The “lowest line charge” does not necessarily result in the “lowest total energy bill” across electricity, gas and fossil fuels usage for households and businesses. As reliance on fossil fuels is reduced, increased electrification will result in an overall reduction in household and business costs.
27. EDBs now face a layer of compounding needs we must deliver on to meet societal and customer needs:
- Customers want reliability to be maintained. There is an increase in renewals as assets commissioned during the rural electrification projects reach the end of their useful lives.
  - More housing is needed. There is a housing shortage and high growth continues manifesting in subdivisions throughout the Canterbury region. In addition, district planning rules for housing have changed. An increase in urban intensification is now allowed and developers are taking the opportunity to build multiple homes where one connection existed before. System reinforcement (LV and HV) and capacity is required to support this shift.

- Customers are connecting new technology, including large scale distributed energy resources to our network. Grid scale solar connections of MW sizing have entered the connection application process and some of our major customers are looking to connect DERs behind the meter. Households continue to connect distributed energy resources, and this trend is expected to accelerate as technology costs reduce. It will be increasingly important to ensure that the benefits of DER and flexibility are accessible to all households, particularly lower socio-economic households to avoid increasing inequity in our energy system. EDBs need to be adaptable to the needs of customers. There are opportunities here to innovate and leverage DER to support system resilience.
- Customers are changing their mode of transportation. Electrification is replacing fossil fuel as the preferred source of energy for transport. The government has incentivised the use of PHEV, EV and hybrids which, over time will promote the uptake of these vehicles in both businesses and households. This should shift loads and reduce overall energy charges (including fuel bills) for some customers. As stated in the Infrastructure Commission's strategy page 54,<sup>9</sup> *"The percentage of electric vehicles in our light-vehicle passenger fleet is projected to grow from less than 1% to 93% by 2050. They're expected to account for more than half of the additional electricity we're going to need by 2050."*
- COVID lockdowns have changed the way consumers balance their work from home and office. This has resulted in higher electricity bills for households which is offset by lower travelling costs to get to work. This has increased electricity consumption and demand from our domestic consumers.
- Energy hardship also needs to take a holistic view across energy sources i.e. vehicle fuel and other heating sources. We have initiatives (e.g. warm homes) to address energy hardship and there are initiatives from other sources that will assist those in hardship.
- Customers want to decarbonise. Major customers are considering their contribution to decarbonisation with a shift of process heat conversions and behind the meter DER.

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<sup>9</sup> <https://media.umbraco.io/te-waihanganga-30-year-strategy/1sfe0qra/rautaki-hanganga-o-aotearoa-new-zealand-infrastructure-strategy.pdf>



- The community is looking to the energy system for resilience in the face of climate change, particularly given the transition-driven increasing reliance on electricity for transport, heat and communication. This includes the need to revisit construction standards, adaptation, and planning for retreat management of physical risks, the need for greater cyber security of our data, control and automation systems, and other related costs from climate change.
28. The global impact of the pandemic means for the foreseeable future, high inflation and significant increases in equipment, material and transport costs has had an impact on EDB's operational expenditure which will be penalised through IRIS in the next regulatory period.
29. Our compliance obligations continue to grow with policy and legislative instruments. These are increasing rather than reducing over time and include:
- Electricity Authority Code and their requirements, e.g. cost reflective pricing
  - New Zealand Infrastructure Commission
  - Climate Change Act (including The National Adaptation Plan, Emissions Reduction Plan)
  - Resource Management Act
  - Civil Defence and Emergency Management
  - Traffic Management and other Health and Safety compliance
  - Task Force on Climate-Related Financial Disclosures (TCFD)
  - Tree management via the Hazards from Trees Regulations
  - Cybersecurity

### What this means for Orion and other electricity lines businesses

30. Orion aims to be New Zealand's most advanced electricity network to enable the energy transition for consumers. The regulatory settings are lagging with this transition. To deliver this for our community, our current context is:

- We have a social obligation to enable electrification to support our communities through our network augmentation so that it is not a constraint. We therefore need to invest ahead of demand as decarbonisation is now a significant driver for our business (Climate Change Act). This needs to be factored into our cost of doing business. The Commission needs to take a broader view when considering revenue setting for distribution businesses whose role is to convey electricity and comply with government legislation.
- As stated in the Infrastructure Commission’s strategy page 10 <sup>10</sup>“*The potential: By harnessing our low-emissions energy resources alongside other complementary technologies like hydrogen, we could treble our annual electricity supply. If we harness these resources, we can attract energy-intensive industries to grow our economy, create higher paying jobs and improve our quality of life. This is good for us and it’s good for the planet.*”
- Maintenance and renewal need to continue at elevated levels from the past, to maintain the health of existing assets.
- In line with delivery of our Network Transformation Roadmap, Orion’s costs have increased to facilitate visibility of our LV networks. These costs support changing connections to accommodate DER. We are seeing increased Opex and Capex to develop greater transparency and control of our LV networks including development of LV in GIS and our distribution management system (PowerOn) and installation of LV network monitoring devices. These costs will only be captured in the next reset and hence, we are not compensated for all of these costs as they arise.
- EDBs are going to need to invest and innovate ahead of demand to support the needs of our customers and the community, and we need the appropriate cashflow to ensure financial sustainability. As stated in the Infrastructure Commission’s strategy, page 11<sup>11</sup>, “*To leverage our low-emissions energy resources we must have:*
  - *The right regulatory settings to enable the development of large-scale clean onshore and offshore energy resources and the networks needed to connect them. For example, the planning system needs to enable the timely development of clean energy generation.*

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<sup>10</sup> <https://media.umbraco.io/te-waihanganga-30-year-strategy/1sfe0qra/rautaki-hanganga-o-aotearoa-new-zealand-infrastructure-strategy.pdf>

<sup>11</sup> <https://media.umbraco.io/te-waihanganga-30-year-strategy/1sfe0qra/rautaki-hanganga-o-aotearoa-new-zealand-infrastructure-strategy.pdf>

- *Reliable supporting infrastructure: This requires an efficient expansion of supporting electricity and telecommunications networks and an efficient use of our gas and fuel networks.”*

EDBs will be restricted in the efficient expansion of electricity networks without flexible mechanisms and the appropriate cash flows.

- Climate adaptation, resilience and hardening investment is needed to adapt our networks as electricity becomes the more dominant mode by which we power Aotearoa. This is to withstand climate change and severe storm events.

31. We have new and increasing operating expenditure. The regulatory regime supports a historic view when setting expenditure allowances with a bias toward capital expenditure (ROI on RAB). Going forward, we need;

- Flexibility on costs related to “access to data” and ability to upgrade our data and digitisation systems (including the use of “Software as a Service”) to increase efficiency, productivity and inform our decision making,
- additional resource to ensure the right capabilities continue to provide appropriate levels of service to customers, and to achieve the shifts required in terms of our Network Transformation Roadmap to support an open network framework,
- to service the cost of compliance as it continues to grow e.g. operational safety, operational monitoring and reporting on climate, increasing engagement with our customers and community and cybersecurity costs.

As stated in the Infrastructure Commission’s strategy, page 93<sup>6</sup> *“The increasing complexity of and connectivity and co-dependency between different types of infrastructure (such as information technology systems for remotely managing water and electricity networks) also come with cyber security risks.”* For example, if the information technology system at Orion at 565 Wairakei Road is compromised by a cyber-attack, this may affect the ability to deliver electricity. As the use of these technologies continues to grow, the risk associated with cyber-attacks is also growing.

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- A regulatory framework that supports non-network alternatives. EDBs require an investment decision methodology which considers whole of system costs delivering consumer and community benefits. This will aid consumers to support demand side efficiency and EDBs to procure flexibility services (Opex) as opposed to network augmentation (Capex). Currently flexibility services are nascent in New Zealand and overseas. The regulatory framework should enable and support these, they should avoid measures which are too rigid as this could prevent innovation or development of new markets.

32. EDB's need the ability within the regulatory mechanisms to offset for scope 3 emissions<sup>12</sup>, as they become more challenging to reduce while providing the regulated service. This includes offsetting carbon credit initiatives where we are unable to reduce our carbon footprint on the environment any further.

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<sup>12</sup> <https://www.oriongroup.co.nz/assets/Company/Corporate-publications/2020-Orion-Climate-Change-Report.pdf>, Page 16, Metrics and Targets with reference to the 3 Scopes

## Questions from the IM Process and Issues paper

We have responded to the Commerce Commission's questions seeking feedback in Annexure A. These relate to the following chapters:

- Chapter 5 – Risk allocation and incentives under price quality regulation
- Chapter 6 – Issues relating to cost of capital
- Chapter 7 – CPPs and in-period adjustments to price quality paths
- Chapter 9 – Effectiveness of the IMs for each sector

## Concluding Remarks

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

Please contact me if you have any questions on [rob.tweedie@oriongroup.co.nz](mailto:rob.tweedie@oriongroup.co.nz) or 027 234 4017

Yours sincerely

Rob Tweedie

Regulatory Manager

## Responses to the IM Framework Paper

### Annexure A:

Annexure A has been compiled in response to the specific questions asked by the Commerce Commission in the Process and Issues paper<sup>13</sup>. The questions posed by the Commission are shown in bold. We have kept the same numbering for cross reference purposes e.g. 5.54 in Chapter 5 corresponds to point 5.54 in the Process and Issues paper.

### Chapter 5 – Risk allocation and incentives under price quality regulation

#### **5.54 To what extent do you agree that efficiency and innovation, and the pace required to lift performance in those areas, are potential issues for all EDBs? To what extent are these potential issues for Transpower?**

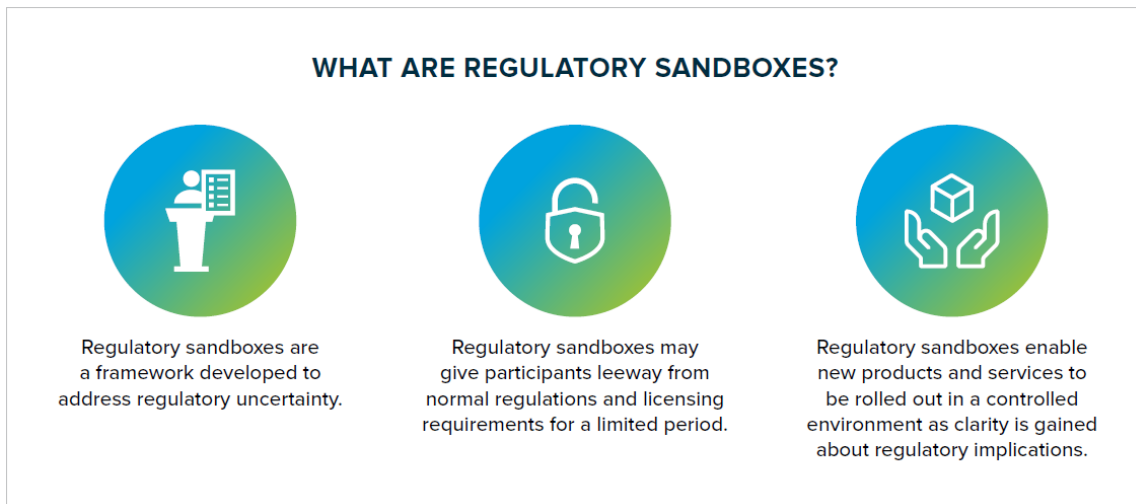
33. We submit that there are regulatory constraints with innovation which impact the pace required to adapt performance given how tightly prescribed the regulatory mechanisms are defined. Further in the discussion under point 5.55, we outline some of the innovations which Orion has undertaken to deliver efficiency and innovation. There is a need to increase expenditure in the short term to explore innovative ideas to support climate change and help form the pathway to a low emissions economy.
34. Most investors / businesses in a competitive market seek certainty in respect of a return on their investment before investing in products, services and solutions. EDB's undertake a similar view to investment i.e. we need to have tangible evidence that customers are adopting these technologies and that we need to build according to consumer demands.
35. Regulators are aware of these challenges and should provide regulatory mechanisms to enable this investment, in a timely manner in collaboration with sector entities. More flexible mechanisms such as regulatory sandboxes and access to in-period contingent allowances / wash-up adjustments are required. Orion attended a presentation on regulatory sandboxes presented by Stratagen in the U.S. The regulators took a forward-looking collaborative view on innovation and the use of Regulatory Sandboxes to accelerate innovation for an Evolving Electric Grid<sup>14</sup>.

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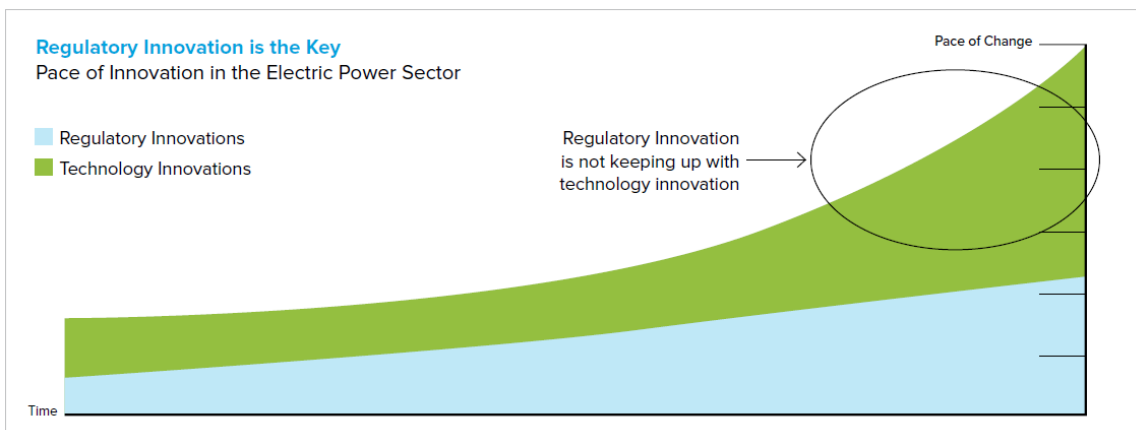
<sup>13</sup> [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0031/283864/Part-4-Input-Methodologies-Review-2023-Process-and-Issues-paper-20-May-2022.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0031/283864/Part-4-Input-Methodologies-Review-2023-Process-and-Issues-paper-20-May-2022.pdf)

<sup>14</sup> <https://www.stratagen.com/stratagen-blog/regulatory-sandboxes>

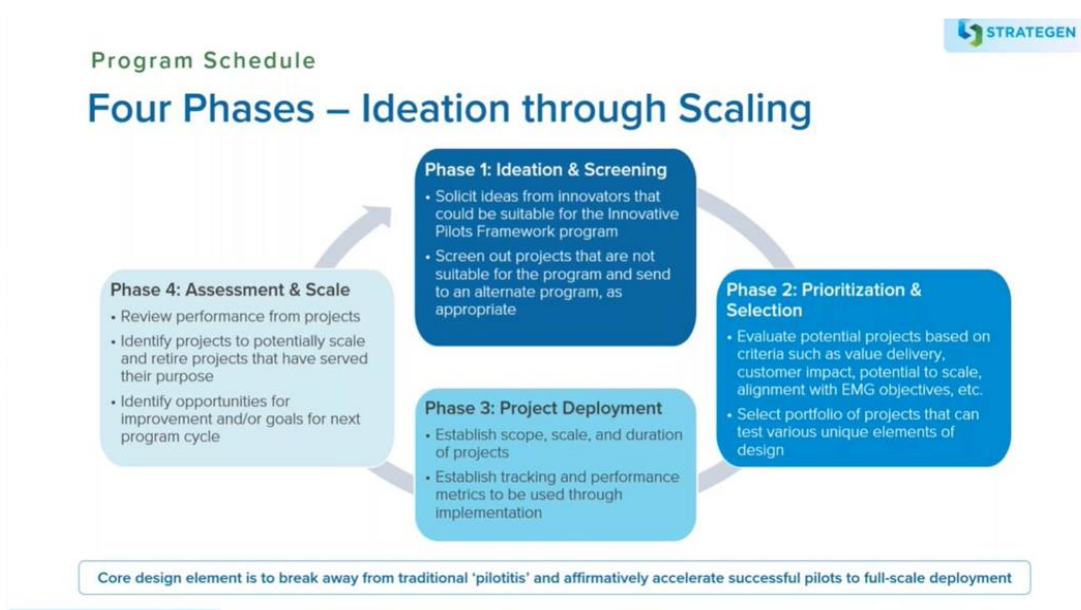
36. The development of flexibility markets and smart energy systems requires extensive innovation support and coordination which are still lacking in NZ. As we transition to a new way of operating the system, accessible innovation funding is needed to de-risk new technologies, solutions, services and processes.
37. The slides below explain the framework and four phases of the project which Stratagen has identified.



**Figure 3: High level overview of regulatory sandboxes**



**Figure 4: Regulatory Innovations vs Pace of change**



**Figure 5: Proposed phases of project screening, selection, deployment and assessment.**

38. Ofgem has also developed an innovation fund which provides pooled resources and has evolved over time, maturing into innovation incentives. Funds are available and there is well developed collaboration across EDBs. All innovation projects are publicly disclosed so that there is transparency in respect of the application of these funds and learnings from their application. We understand, from our conversations with them, that the ENA (UK) believes this has been a critical element in service of shifting the regulatory regime forward and delivering for the transition. We urge the Commission to investigate this option as a part of the IM Review.



**5.55 We welcome evidence of the role that efficiency and innovation performance have played in the significant expenditure increases by EDBs and Transpower since 2008.**

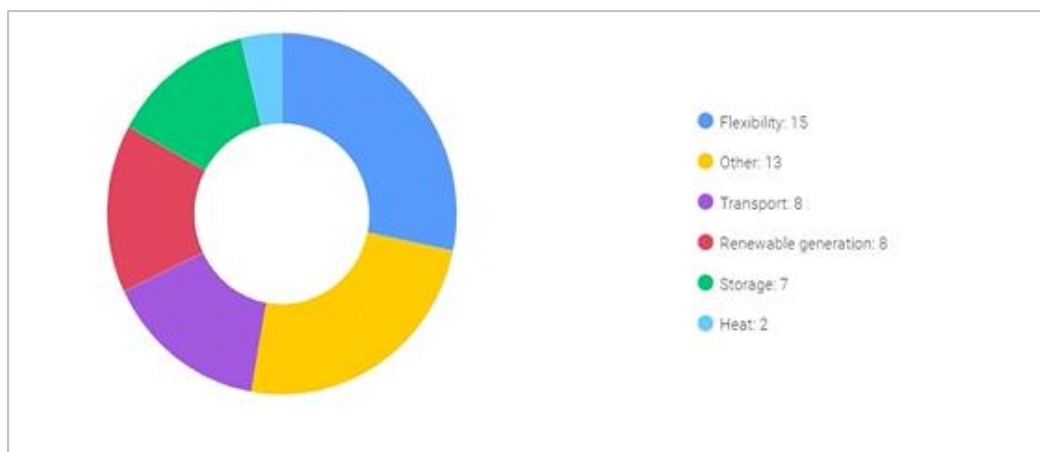
- **Commerce Commission "SolarZero response to 29 April open letter" (28 May 2021) p.1, 3 and 7. 77 See sections 107 and 108(4) of the Electricity Industry Act 2010.**
- **Commerce Commission "Wellington Airport Response to 29 April Open Letter" (31 May 2021), page 3. 60**

39. Notwithstanding limitations with regulation, the following are examples of where Orion is working to increase efficiency and innovation. These activities increase our expenditure. Delivering efficiency and innovation are not nil expenditure activities.

40. Orion has been pro-active in responding and building capability to drive efficiency and innovation. We have developed an innovation process and pipeline with limited resources and access to funding would assist us in delivering this work faster.

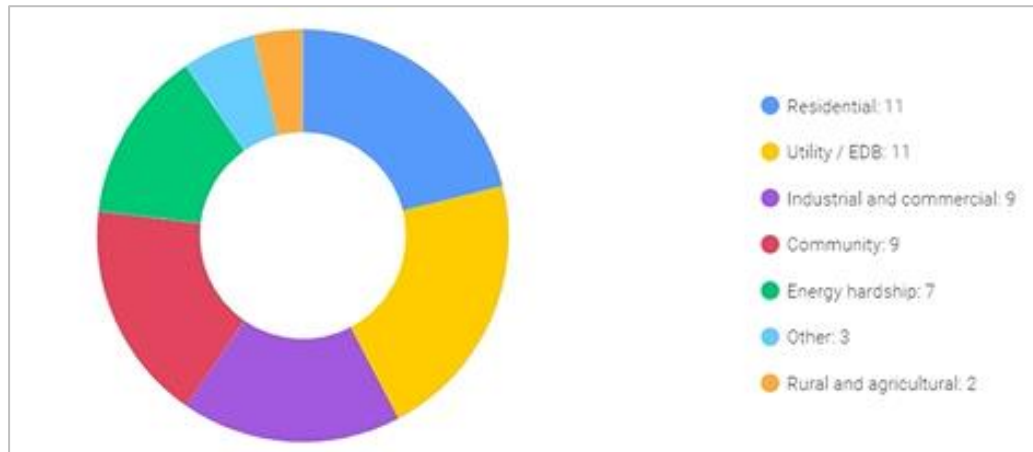
41. The following graphs show the target project types and customers groups that our pipeline has currently identified.

- The type of projects that have been identified are listed below. Flexibility does not currently fall within the scope of the innovation allowance although we can see that this is critical for future delivery of services.



**Figure 6: Orion Innovation Pipeline: Project types**

- The types of customers involved in the innovation pipeline are detailed below. We are particularly focussed on innovation in the EDB sector to provide a more efficient service, but we will work with other partners where this makes good sense.



**Figure 7: Orion Innovation Pipeline: Customer demographics**

- Orion’s participation on FlexForum<sup>15</sup>- The industry is not adequately incentivised to be innovative and FlexForum was initiated by industry participants to establish collaboration in this space. FlexForum’s purpose is to support and develop an optimised energy system. FlexForum intends to break down the silos across the industry and unlock the value stack for consumers and strengthen the business case for consumers to invest in, and promote a faster and equitable transition to DER. We appreciate that it sometimes costs more to deliver best outcomes for consumers and time to get a better view of whole of system costs. We also believe that FlexForum will drive consistency around costs with EDBs and stakeholders that are fit for purposes for NZ through an open and transparent process. This involves stakeholders devoting time to participate in the forum and trials will develop from this.
- Orion submitted an entry into the Energy Excellence Awards. The project involved adopting Statcoms and biodiesel to reduce emissions for low carbon generators. This will open the pathway to enable large generators to convert with confidence to also decouple from diesel.<sup>16</sup>

<sup>15</sup> <https://www.araake.co.nz/services-projects/flexforum/>

<sup>16</sup> <https://www.energyawards.co.nz/content/orion-%E2%80%93-pioneering-low-carbon-generators%E2%80%8B>

- Orion has engaged with Community Housing on sustainability. This incurred \$25k in direct costs and sunk costs such as staff time. This project is still running, involves engagement with consumers and the installation of metering to monitor their consumption. The consumption information is channelled through to the OCHT Operations Manager to assist in making decisions for home star 4 or 6 on future builds. This also provides efficiency gains and efficient energy use for Orion and customers.
- Our ADMS (Advanced Distributions Management System) project has increase automation and control of the LV network since its inception in 2010. In 2021, the 'lifecycle' upgrade cost was approximately \$500k which is undertaken every 5 or so years. There are additional annual licence fees. We are also able to begin managing the LV network with automation of switching to restore power automatically soon. Our 'Peak' tablets have been around since 2016 and have recently had a major upgrade as well. These tablets send incidents and operating steps to field operators to view a live updated diagram in the field, and online sign off against operating procedures with built-in safety logic. This information updates the website for customers and tracks our outage minutes.
- Orion introduced the Energy Accelerator programme<sup>17</sup> in partnership with Ara Ake and Ministry of Awesome amongst other stakeholders. The intention of the programme is to engage with our community to find innovative solutions.
- Drones have been acquired to assist our field staff to access remote parts of the network with ease and enhancement of safety. It has reduced time spent on inspections and driving to access points on the network. This has proved to be a more effective and an efficient use of time and resources.
- Orion was one of the first organisations to produce a TCFD<sup>18</sup> report in New Zealand to front foot the impact of our operations on the environment by identifying ways of mitigating our carbon footprint.

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<sup>17</sup> <https://www.orionaccelerator.nz/>

<sup>18</sup> <https://www.fsb-tcf.org/>

- Orion provides Akaroa with a single line from Duvauchelle. Orion upgraded kiosks to provide an alternative power supply by generating power at the shopping centre in Akaroa. This delivers a backup supply for the remote community if their power line goes down. The cost was \$180k and other miscellaneous sub-jobs. We then utilised this, and in partnership with our project management office maximised an outage window in conjunction with generator power supply by coordinating a number of programmed work packages across 3 contractors to increase economics, efficiency and productivity while continuing as much service as possible. This delivered a backup supply for the remote community if their power line went down. The cost was \$180k and other miscellaneous sub-jobs.

**5.56 What role do you see the IMs playing (alongside other regulatory tools) to incentivise improvements in efficiency and innovation performance?**

42. We need dynamic regulation and a better designed innovation allowance: The IMs need to provide flexibility for the foreseeable changes in DER, electrification of the economy and changes in consumer demands. This includes being able to adapt and to promote the long-term benefit of consumers.

**5.57 To what extent do you agree that changes to incentive mechanisms in the IMs (such as Opex IRIS) should be informed by evidence of their effectiveness? And if the evidence were insufficient to reach a conclusive view, to what extent do you agree that the IMs should only provide for the relevant incentive mechanisms, while the implementation details are determined at PQ resets?**

43. The IRIS mechanism is complex and results in long term impacts into subsequent regulatory periods and is still not well understood by EDBs. It is challenging for EDB's to make trade-off decisions on expenditure needed to address the immediate needs of customers, legislative compliance and the expectation to provide open network access. The increased expenditure needed for common assets on the distribution network has a trade-off against the impact of IRIS. This makes it ineffective in the sense that there are IRIS consequences of overinvesting even in service of the customer.

44. A Totex approach would provide more flexibility (refer to Ofgem's RIIO-2 determination, chapter 5<sup>19</sup>) to achieve a cost effect service. This should also effectively improve the investment decision making process by:

- allowing for flexibility between investment and operational expenditure
- simplifying the IRIS mechanism with equal weighting for Totex (Capex + Opex).

45. We agree that the IMs should provide for the mechanisms / framework, with the implementation being determined in the PQ and DPP resets.

**5.58 Independently of the evidence base on the effectiveness of incentive mechanisms in the IMs, and considering the role of certainty, to what extent do you consider that the IMs should only provide for the relevant incentive mechanisms, while the details are determined at PQ resets?**

46. The incentives, specifically relating to innovation need to be clearly defined and agile as there is uncertainty around how the market will evolve over the next decade. We agree that, for the next decade that only the incentive mechanisms should be outlined in the IMs with the PQ resets determining the incentive allowance details.

**5.59 Is the current allocation of risks and rewards between consumers and suppliers appropriate and effective in driving innovation in line with the Part 4 purpose? If not, how should it change?**

47. Many of the innovations required are directly related to the choice's consumers make in respect of connection and operation of new technology over time.

48. The design of the current innovation allowance places the risk entirely with the EDB until the project expenditure is completed. Some innovation programmes may take a number of years to complete.

49. We do not believe the current innovation allowance design allocates risk fairly between consumers and suppliers.

50. The regulatory regime has historically operated and been designed for a relatively predictable environment. Innovation however, like R&D, is inherently based in trial and experimentation without certainty of an outcome that will result in success e.g. failure and learning from that can be a natural outcome. Therefore, reward is more subjective in this environment and may be more intangible e.g.

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<sup>19</sup> [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)

the learning, a form of reward from the exercise, leads to subsequent innovation that may be successful.

We submit that if the regulator sees innovation as important, and we believe it should, then incentives for innovation should be more ex ante, support cross sector collaboration/partnership by EDBs, and provide for more than one window of application in a financial year.

**5.60 To what extent do the IMs limit the form or scope of innovation in a way that is not in the long-term interests of consumers consistent with the Part 4 purpose in s 52A?**

51. Innovation is critical to the electricity industry to keep up with the changing demands of consumers and to meet national net zero objectives. The current IM settings do not address these changes when they occur and are therefore neither timely nor responsive to the pace of change. Orion has approached the Commission during 2021/2022 regarding the innovation allowance and a potential Capex reopener, and these initiatives did not meet the criteria despite being very relevant to deliver on our network transformation roadmap and net zero.
52. The Commission can take a permissive approach to EDB activities in respect of climate change and sustainability under 5ZN. Given our role as a critical enabler in this context we believe the Commission should apply this permission more liberally than sparingly in respect of innovation and other incentive mechanisms. This is especially needed where it is desired by customers or is enables us to meet the various legislative obligations on us.
53. The regulatory sandbox (discussed in point 32) should provide more quantum and flexibility of innovation allowance and assist in defining decisions for innovation.

**5.120 We are interested in the views of stakeholders on the effectiveness of the current efficiency mechanisms. Specifically, we invite submissions on:**

54. Refer to point 5.57 regarding the IRIS mechanism and further explanations below.

**5.120.1 What evidence is there that IRIS and other expenditure incentive mechanisms are driving Capex and/or Opex efficiency improvements?**

55. We are conscious of the IRIS impact and have developed a regulatory model to understand its implications on investment decisions. During this regulatory period, we have undertaken a significant change to our business model/reorganisation, so that we are better placed to deliver the capability and shifts needed to meet consumer expectations, including the need for decarbonisation. We have also reviewed our key digital systems and are making or planning to make enhancement to increase efficiency, service and system integration. Along with this many of our processes are being mapped and reviewed for streamlining so they will deliver the right outcomes for customers now and in the future.
56. Our forecast expenditure is quite different to historical trends. Our view is that a historical view to setting expenditure allowances by the Commission does not provide for forecast increased expenditure to facilitate longer-term efficiency gains going forward.
57. There are some negative incentives:
- The Opex Allowance is assessed on historical spending patterns;
  - The Opex IRIS disincentivises non-network alternatives going forward (i.e. spending to provide solutions through services which cannot be added to the RAB)
  - This could result in additional debt if the Opex allowances and revenue does not allow for an allowance assessed on future / forecast spend.
  - Reopeners only accommodate Capex and not Opex- most projects require spend in both categories
58. The perverse result is that EDB's could overspend in the short term (with an IRIS penalty) to put efficiencies in place for the longer-term benefit of consumers. The Opex IRIS incentive is not a smoothed recovery and can result in price volatility for customers when we look to recover our allowable revenue. We recommend that the Commission review the post regulatory period impact of Opex IRIS and look to match the approach to Capex IRIS, which is spread more evenly over the 5-year period or preferably consider a Totex approach to IRIS.

### **5.120.2 To what extent have we designed the mechanisms properly, to give effect to the desired incentives?**

59. The IRIS, Quality of Supply and Innovation incentives are working as the Commission intended. However, they could be optimised as follows:

- The IRIS incentive should be reviewed to address inconsistencies between Opex and Capex IRIS and take a Totex approach.
- Quality of Supply incentive changes have taken time to implement and we were unable to get clarification from auditors to ensure that we have complied with the regulations to claim the incentive. We recommend that when the Commission implements incentives they offer clear guidance on implementation and audit requirements for compliance. It does not appear that the mechanism (i.e. planned notified outages) has provided any better outcomes for consumers nor reduced SAIDI or SAIFI limits.
- The Innovation incentive design and implementation was a welcome introduction to the regulations which can be refined further by taking an ex-ante approach, recognising multi-year programmes of work that may go across regulatory periods, and provide more windows for application during a financial year<sup>20</sup>.

### **5.120.3 What alternative mechanisms could be implemented to achieve the intended outcomes with less complexity?**

60. A Totex approach to IRIS would reduce complexity and provide more flexibility in making Opex and Capex investment decisions.

With reference to the *'Incentives on business plans and Totex submissions RIIO-2 cross-sector workshop'* Ofgem presentation<sup>21</sup>. The Totex incentive mechanism has two roles:

- Outset of price control: incentivise companies to submit forecasts which the Commission can confidently use for setting the level of allowed Totex

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<sup>20</sup> Refer to the conclusion and discussion points section of Orion's Innovation Allowance Application page 19/20-  
[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)

<sup>21</sup> Page 8, [https://www.ofgem.gov.uk/sites/default/files/docs/2018/09/business\\_plans\\_and\\_totex\\_incentive\\_workshop\\_-\\_26\\_september\\_2018.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2018/09/business_plans_and_totex_incentive_workshop_-_26_september_2018.pdf)



- During the price control: incentivise companies to spend below their allowed revenue by rewarding them with a share of the difference between the allowed revenue and their actual spending.

We note that it may not be desirable to rely solely on ex-ante allowances. This is particularly true where:

- past information is not a good predictor of the future and there is high uncertainty
- costs are outside of companies' control and they are not best positioned to manage risks

61. We recommend using uncertainty mechanisms to accommodate for less certain but possible expenditure signalled by EDBs in their AMPs

62. The innovation allowance could be revised to provide EDBs access to funds for R&D and decarbonisation purposes. This may not reduce complexity but will provide more flexibility to respond to the demands of customers.

#### **5.120.4 To what extent do suppliers understand the efficiency incentive mechanisms (and the outcomes that they are intended to achieve)?**

63. The intent of the IRIS incentive mechanism as applied by the Commission is for EDB's to become more efficient. We therefore believe that, as suppliers of electricity that the mechanisms are understood (although very complex) but not sure that they deliver the outcomes needed for efficiency.

64. These incentives provide the pathway to efficiency, however there are certain factors out of EDB's control that negatively affect the intent of these incentives to distributors. This is evident in the current economic climate i.e. much higher inflation (see graph below) that we have seen over the past decade artificially resulting in overspending in capex and Opex<sup>22</sup>, demonstrated by supply chain disruptions increasing costs and by changing but not foreseen customer connection activity that cannot be met through a Capex reopener.

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<sup>22</sup> <https://figure.nz/chart/1Vny7YwmIO8OoPNe-aoMb3PU42b6z7XK5>



**Figure 8: New Zealand actual inflation trends**

**5.120.5 Are they willing to respond to them?**

65. EDBs will respond to incentives where possible. Given the complexity of the regime it is not always possible to respond to one signal without having an unintended consequence occurring on another e.g. to achieve an efficient state (IRIS incentive) could result in lower investment level due to increasing costs (less value for money) under constrained allowances for instance e.g. current increases we see post pandemic from distribution and supply chain disruptions.

**5.120.6 Are they able to respond to them?**

66. The capability of EDBs to respond to innovation mechanisms to meet needs of customers (e.g. decarbonisation and as noted above and below) is questionable. The Commission needs to facilitate our ability to respond through its regulatory approach.

67. There is a disincentive on Opex spending that could go counter to building and attracting the right capability. The current market is also tight, and market pay expectations have risen in the wake of COVID. This is a trade-off we need to continually balance and provides challenges in responding to the incentive mechanisms.

68. Orion reorganised and introduced processes to support an innovation pipeline however the design of the current innovation allowance may discourage EDBs accessing it when there are other potential

avenues that are ex-ante and have more application windows i.e. refer to the Commerce Commission's decision.<sup>23</sup> The formal application was rejected because it did not meet the criteria of the innovation allowance primarily because the money had not yet been spent and offsetting carbon was not considered innovative or in line with the definition of electricity lines services . We raise this because as part of the process we identified several limitations/disincentives with the current innovation allowance design that may be deterring applications.

69. We submit that the narrow view taken in line with the existing definition for electricity lines services, that is very 'poles and wires' centric, may inhibit EDBs from responding to incentive mechanisms in a modern-day way.

70. We submit that and recognising this is not within the scope of the IMs, a review of the definition of electricity lines service may be needed in the near term.

**5.120.7 If so, how effectively, and at what cost? Ex-post efficiency reviews have their own risks – they can have a detrimental impact on ex-ante incentives to invest. But if the net effect is likely to be positive, then doing such reviews may better promote the Part 4 purpose.**

71. The way the IRIS incentive currently works needs to be looked at in conjunction with the WACC settings in respect of incentives to invest. Investors look for an appropriate rate of return while, at the same time promoting the Part 4 purpose.

72. We submit that it's important for the Commission to explore the commentary in the disclosed AMPs that explain the forecast expenditure proposed and may provide insights into innovation, efficiency and productivity. Other corporate disclosures can also assist e.g. annual reports and statement of intent. Ex-post efficiency reviews may not be needed beyond these.

**5.120.8 Has the expected behaviour in response to the mechanisms eventuated? If not, why not?**

73. The mechanism has been considered when making decisions and has driven behaviour in most cases. However, there are other factors when weighing up whether to respond to the mechanism, these

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<sup>23</sup> [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0030/279723/Commission-response-to-OrionE28099s-Innovation-Allowance-Application-15-November-2021.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0030/279723/Commission-response-to-OrionE28099s-Innovation-Allowance-Application-15-November-2021.pdf)

include the cost versus benefit of implementing the necessary processes to qualify for the incentive or the ease of access to an allowance.

**5.120.9 Is there a bias towards one type of expenditure (Opex or Capex) due to the incentive mechanisms or other factors? Are the incentives strong enough to be incentivising efficiency savings for each type of expenditure?**

74. Orion believes there is a bias toward Capex over Opex. This is not because EDBs do not want to implement Opex solutions. However, commissioned asset additions to the RAB drives the return of and on capital which is a significant contributor to the BBAR and ultimately the MAR. The IRIS impacts of Opex spending is also more sizeable whether in the favour of the customer or the EDB. The decarbonisation transition toward net zero will be better served by EDBs having incentives to invest in Opex solutions e.g. non-network alternatives, digitisation delivered through the cloud, customer-oriented flexibility services. The effect of the IRIS may also be to drive up debt funding for EDBs to meet customer connection pace and extent of decarbonisation. Further to this, we note the Commission's interest in carrying out a confidential debt survey. We strongly believe the time has come for a Totex approach.
75. At the DPP3 reset the Commission equalised the weighting of the Capex and Opex incentive at 23.5%. However, the calculation of the IRIS incentives is not the same in all respects between the Capex IRIS incentive and the Opex IRIS incentive.
76. The incentives are strong signals to become efficient. However, a Totex model eliminates the need for making investment decisions between Opex and Capex spends.

**5.120.10 IRIS sets marginal incentive rates for regulated suppliers, but suppliers may make spending decisions based on overall budgets and/or targets, rather than based on incremental Capex/Opex. Others might have internal hurdle rates for investment decisions that are higher than WACC. How does having a marginal incentive rate impact on a supplier's expenditure decisions?**

77. The marginal incentive rates have an impact on expenditure decisions. However, it is not the only factor when making the decision whether to spend or not. In our experience the investment decision is made based on providing consumers a reliable cost-effective power supply.
78. The revenue cap is the probably the most important incentive to manage price shocks for customers and limit a regulated business to earn excess revenue. Expenditure decisions would be based on earnings, which includes cost of servicing debt (financeability) due to increased capital expenditure to service customers within the context of the regulated framework.
79. Shareholders may also opt to look at alternative investment options outside of the regulated business (competitive markets) where they are able to earn returns higher than WACC.
80. Some decisions may not be primarily driven by WACC or earnings return but may be driven by ethical leadership and community outcomes tied to electricity lines service and in line with an EDBs purpose. Our long-standing sponsorship of Community Energy Action is such an example and, our sponsorship seeks to address energy hardship through the health of homes (kete)<sup>24</sup> and to improve efficiency of energy use for our customers. Financial support through sponsorships for community initiatives in our area is part of our social licence to operate and provides the electricity line services with an avenue to contribute in curbing energy hardship.

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<sup>24</sup> MBIE has defined energy wellbeing (Energy hardship, as the inverse of energy wellbeing, is the opposite of this definition) as: *'When individuals, households and whānau are able to obtain and afford adequate energy services to support their wellbeing in their home or kāinga.'* The Energy Hardship Expert Panel has developed 5 [kete](#), baskets, each containing a list of issues or underlying drivers of energy hardship to focus their collaboration, conversations, identify problems and develop solutions: Health of the home, Energy accessibility, Consumer protection, Knowledge and navigation, Energy affordability

**5.120.11 Do stakeholders have other issues or opportunities relevant to the efficiency incentive mechanisms currently defined in the IMs? Have we captured the key stakeholder issues?**

81. Yes, the stakeholder issues have been captured comprehensively in table 6.

**5.120.12 There are suppliers, such as community-owned EDBs, that may not have profit-maximising motives. Are there other ways of incentivising these suppliers that may not respond to financial incentives (e.g. benchmarking)?**

82. Conceptually, community-owned EDBs would have a focus to deliver better outcomes for customers. Their consumers also look forward to receiving their annual refund/discounts from the trust. However, you will find that it is in the DNA of all EDBs to serve their communities.

83. Information disclosure and the Commission's performance summaries are affective ways to inform EDBs about their relative performance and focus areas.

**5.137.1 Do Stakeholders consider there are substantial reasons to change the form of control for any of the Part 4 sectors.**

84. There are concerns around assumptions which the Commission has made regarding productivity. Refer to figure 10.9 on Page 159<sup>25</sup> "*Electricity distribution Opex productivity indices, 1996-2018*" which is extracted from an ENA report and Figure 10.10. Firstly, we need to point out that both Transpower and EDB's were in a state of decline since 2016 and that the time scales of the graphs differ. Secondly, Transpower's forecasts from 2018 onwards show a slight increase in productivity with no forecast shown in figure 10.9. Thirdly, Figure 10.9 needs to include Electricity distribution Opex productivity forecasts or actual indices to 2022 to provide conclusive evidence of our productivity rates at the DPP3 WACC and other adjustments made by the Commission. Finally, the operating context for EDBs needs to be considered when reviewing the data- see our points 24-29 above. We intend to respond to these assumptions in future submissions on the IMs.

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<sup>25</sup> [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0031/283864/Part-4-Input-Methodologies-Review-2023-Process-and-Issues-paper-20-May-2022.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0031/283864/Part-4-Input-Methodologies-Review-2023-Process-and-Issues-paper-20-May-2022.pdf)

**5.137.2 Any parts of the revenue cap/WAPC mechanisms require a change for improved implementation.**

85. The revenue cap is operating as intended and provides price certainty for consumers. We recommend smoothing passthrough and IRIS adjustments over the 5-year DPP period, to reduce the impacts of decreases or increases in revenue (effecting prices) year on year.

**Longer-term demand risk**

**5.182 We invite submissions on the issue of long-term demand risk allocation. Specific focus areas include:**

**5.182.1 whether the IMs should be changed to allow for more long-term demand risk to be allocated to certain regulated suppliers, and if so, why; and**

86. At this stage we run the risk of potential increased demand due to electrification (EV's and decarbonisation) offset with other DER (Solar installations, etc) and therefore require a more flexible regulatory regime. We agree that changing the IMs to allow for more long-term demand risk for certain regulated suppliers is worth exploring.

**5.182.2 where long-term demand risk remains primarily with consumers, what IM changes would assist to provide more certainty for consumers in allocating risk between current and future consumers.**

87. Orion welcomes the Commission's decision to approve Unison's application for a re-opener<sup>26</sup>. We appreciate that this was an unforeseen event and met the threshold for a re-opener. Orion has had several projects which we have considered for a reopener but fell short of the threshold of \$2 million and 1% of MAR. However, the sum of these over time more than exceeds these thresholds. We do not expect to increase revenues during the 5-year period, but we do expect the regime to

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<sup>26</sup> [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0027/278109/Final-Decision-Reconsideration-of-default-price-quality-path-for-Unison-Networks-Limited-04-March-2022.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0027/278109/Final-Decision-Reconsideration-of-default-price-quality-path-for-Unison-Networks-Limited-04-March-2022.pdf)

provide flexibility and more timely response to assist us to meet the demand driven directly by consumers activity.

**5.183 We also welcome views on the suitability of the methodology we used in determining the stranding allowance in the Fibre IMs for other sectors.**

88. No comment.

**RAB Indexation and inflation forecasting**

**5.225 We invite submissions on:**

**5.225.1 Whether suppliers prefer an indexed or unindexed RAB and why – i.e. whether returns should be maintained in real terms? The answer is likely to be informed by preferences to risk exposure (stranding/price shocks risks vs inflation risk).**

89. Our understanding is:

- Indexed RAB, unindexed RAB and accelerated depreciation need to be considered in conjunction with the debt survey and the anticipated increase in interest rates in the short term.
- Unindexed RAB allows for the recovery of inflationary increases as they occur. This is useful for recognising revenue sooner where there are large capital investments funded from debt. This is particularly appropriate in times of higher levels of inflation and rising interest rates to service debt for these large investment projects.
- Indexed RAB protects consumer from price shocks fulfilling the objectives of Part 4, as there is an uplift in prices to compensate for inflation. However, the commissioned assets or RAB is effectively only included into the building blocks for allowable when revenues are next reset on a 5-year cycle.

90. The two mechanisms have worked well for Transpower (unindexed) and EDB's (indexed) up to this point. Orion recommends that both options are kept in the IM's and a decision is made in the DPP's on the appropriate application of both options. This will can only be fully assessed once the Commission has gathered information on EDB debt levels through the confidential debt survey.

91. We could only provide further comment on these options once the Commission has assessed the levels of debt and associated risk exposure to EDBs.



**5.225.2 Whether we should reconsider the unindexed RAB approach currently applied to Transpower.**

92. We support Transpower for the most appropriate approach to support their business funding requirements.

**5.225.3 How does the current inflationary environment, where actual inflation has been higher than forecast, affect the answer to the above question?**

93. There are a few factors which inflation effects for indexed RAB. These are:

- The forecast inflation used in BBAR set every 5 years
- The actual in-period annual adjustment when setting prices for revenue.

94. An unindexed RAB approach would assist EDB's in being compensated on a timely basis than the indexed RAB approach as discussed in 5.225.1. Orion has seen an escalation in project costs over the past 2 years which are far in excess of the Reserve Bank's issued actual inflation figures.

95. An unindexed approach may be a better option in the event of significant increases in inflation in the current inflationary environment and given the degree of change that may be driven by the energy transition.

**5.225.4 Will consumers be better off under an indexed or unindexed RAB and why?**

96. Indexed RAB provides consumers with more certainty on prices during the 5-year DPP period.

97. Each approach alters the timing of cashflow and this may be a consideration during an energy transition.

98. We note that both approaches require the pricing signals (recovery of revenue) to be passed through to customers. However, these prices (charges) are not always passed through by all retailers to end consumers. We have seen this where consumers are charged the same price by a retailer despite various price signals from lines companies in a region e.g. Canterbury.

**5.225.5 Whether there are other unbiased inflation forecast methodologies that could be considered alongside or in addition to our current inflation forecasting approach.**

99. The RBNZ has a complex inflationary forecasting mechanism and we consider this a logical point of departure as an input into regulatory settings.
100. The Commission should consider historical actual inflation against historical RBNZ forecasts to ensure that they are comparable. This should provide a better forecast for our regulatory mechanisms and minimise corrections at DPP resets.
101. We recommend that the Commission revise the methodology of forecasting inflation to better match historical inflationary performance and consider use of market-based estimates to inform the glide path used in the Commission's current approach.

**5.225.6 Whether there are any issues with the existing CPI wash-ups for price-quality paths to adjust for differences between forecast and actual CPI.**

102. The wash-up mechanism is working as expected. The only downside is that the timing between the CPI being published, finalising the Price Quality Compliance and setting the following year's prices. This is a significant delay in recovering CPI adjustments for wash-ups e.g. two years.

**5.225.7 The market for inflation-linked bonds in New Zealand and whether it provides suppliers with an efficient way to protect against inflation risk.**

103. The use of bonds as a mechanism is appropriate when calculating the return on investment. This is used every 5 years to set the price path. At the point when DPP3 was set the bond yield rate was low which resulted in lower returns for EDBs WACC settings. Historically this has been an acceptable measure. However, the past 2-3 years has changed the economic environment significantly resulting in much higher inflation than forecast. In our opinion, bonds have not been an efficient way to protect against inflation risk over the past few years.

## Chapter 6 - Issues relating to the cost of capital

**6.116 We invite submissions on any of the issues identified in this chapter, as well as on any other cost of capital issues interested parties consider we have not identified or previously addressed adequately. We encourage interested parties to use our draft IM review framework to show why the relevant issues should be prioritised and resolved in the IM review.**

104. We refer to paragraph 5.99 in the Process and Issues paper which states: *“Mr Duignan, in his submission on the DPP3 reset, considered that the midpoint level of the WACC (50th percentile) should be used rather than the 67th percentile for the discount rate used in calculating the strength of the relevant IRIS and WACC”*.

In point 10.12 the Commission stated *“Profitability across EDBs has been below estimates of reasonable returns. Our estimate for the WACC was 7.8% for 2011-2015 and 6.4% for 2016-2020. The industry returns tended to be lower than these levels, suggesting that local lines companies were not making excess returns. This may be consistent with weak or negative productivity growth, but also with voluntary undercharging.”*

105. We would like the Commission to consider:

- The current WACC setting for DPP3 (2021-2025) is 4.23% 67<sup>th</sup> percentile estimate of post-tax WACC and should not be reviewed to the 50<sup>th</sup> percentile. We acknowledge that the “risk free rate is used in calculation the cost of debt and the cost of equity. The risk-free rate is the interest rate than an investor would require to invest in a riskless business”<sup>27</sup>. The Commission has stated that returns have already tended to be low and a further drop in WACC into DPP4 would reduce our ability to respond to the energy transition even further. We also consider that the EDBs are not entirely riskless and plan to submit on this later in the consultation process.
- Voluntary undercharging would probably only be used where EDBs can directly impact end consumer power bills (i.e. directly billing to mass market customers) as undercharging (revenues) will have a flow on effect and unintended consequence of underfunding asset maintenance and

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<sup>27</sup> Par 35, [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0035/95579/Draft-Guidelines-The-Commerce-Commissions-Approach-to-Estimating-the-Cost-of-Capital-October-2005.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0035/95579/Draft-Guidelines-The-Commerce-Commissions-Approach-to-Estimating-the-Cost-of-Capital-October-2005.pdf)

renewal (expenditure). The data presented on productivity needs further analysis and we intend to submit on productivity assumptions at a later stage of the consultation process.

**IM review framework to show why the relevant issues should be prioritised and resolved in the IM review.**

**6.117 We note that we shall be undertaking a confidential debt survey as part of the review and so will be actively contacting suppliers to seek further information**

106. We welcome the Commission's initiative to survey financeability by assessing EDB's debt exposure, as the Information Disclosures have been focussed on performance with limited information about financial position.

107. We recommend that the Commission also undertake a 'self-insurance' assessment at the same time to assess the risk of exposure of assets which cannot be insured or are uneconomical to insure where premiums are too expensive. Orion has been in a position where we have applied for CPP to recover costs associated with a natural disaster. It will also provide insights into future risks resulting from climate change such as:

- recovery for lines and cables costs in a significant event.
- if climate related events become more severe and more frequent then we will be accessing self-insurance more often.
- EDB's may need to fund these events via debt unless they have made provision for this via a pool of money.
- ensuring that networks can withstand the effects of climate change will become more important to ensure quality of supply. Resilience from a significant event should be included in the IM's under Subpart 6<sup>28</sup>. At this stage significant events are being covered under operational costs in most cases and we foresee this becoming more frequent in the future (e.g. there is potential for a step change).

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<sup>28</sup> [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)

## Chapter 7 - CPPs and in-period adjustments to price- quality paths

**7.43 Overall, we seek your views on the capacity for price-quality paths that we set to flexibly respond to an upcoming period of rapid change in the policy environment and technology. Given our current IM mechanisms for adjusting, reopening or replacing price-quality paths, ranging from pass-through costs, recoverable costs, through to reopener mechanisms and then to IM requirements for CPPs, we invite you to tell us whether there are issues to be resolved in the IMs, particularly:**

108. We refer to the summary of key themes identified by the Commission from submissions to their open letter <sup>29</sup>. The issues included certainty, innovation, scale, flexibility and investment. Our responses are as follows:

- Certainty – to mitigate risk of disruption and higher costs, we will need to invest ahead of demand and the IMs need to consider how we manage uncertainty.
- Innovation – EDBs require better sources of funding which can provide for innovation and ensure that the right solutions are arrived at. We have detailed our innovation under the Commissions' point 5.55. Scale - given the size of the investment uplift required the current DPP historical basis for forecasting expenditure is not appropriate for setting future revenues. We need a more forward-looking approach. Scale also needs to take a more holistic approach to qualifying for incentive mechanisms e.g. \$2 million minimum is restrictive when we have multiple projects which make up significantly more than \$2 million.
- Flexibility – EDBs are not able to forecast everything perfectly in AMPs, and these are used to set PQ paths so flexibility is needed for in-period adjustments. CPPs are too cumbersome, time consuming and existing reopeners not flexible enough.
- Investment - real returns are not consistent with WACC, debt compensation and the current inflation environment.

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<sup>29</sup> [Open-letter-on-priorities-for-Energy-and-Airports-Summary-of-key-themes-from-submissions-12-October-2021.pdf \(comcom.govt.nz\)](#)

**7.43.1 where uncertainty suggests reopeners or other mechanisms are not adequately provided for in the DPPs, CPPs and the IPP;**

109. The criteria for reopeners is currently quite narrow and not reflect of real project costs. An example of this was the Unison<sup>30</sup> decision where the re-opener did not allow for compensation of the additional operational expenditure associated with the project. There are operational costs associated with the capital investment of assets which needs to be considered by the Commission within reopeners.
110. Some of Orion's DPP3 projects have not met the \$2 million threshold for a re-opener although came close to this value. This means that the introduction of reopeners does not address multiple projects intra-regulatory period which collectively exceed the \$2 million threshold substantially and it may be appropriate to revisit the level of this threshold. We note that differing approaches to capital contributions may also inhibit reaching the threshold.
111. Orion is also forecasting to spend additional on cyber-security, legislative changes and associated compliance costs which were not historically in our expenditure. Utility businesses face increased compliance with government policy as a key enabler to electrification and decarbonisation (e.g. Climate Change Commission, National Adaptation Plan, etc.) which we are not being compensated for under an historical view of setting allowances.
112. The innovation allowance has been a good signal for EDB's to look at projects which could provide a more effective service to consumers. The allowance requires retrospective approval of expenditure. This means that EDB's carry the full risk of the innovation project until completion when the Commission may or may not approve an allowance against the spending. Shareholders would want certainty when investing in innovation and research and development that there will be a return on their investment. While we ensure that Part 4 of the Act is preserved, there are challenges in being innovative in a rigid regulatory regime. The rules for the innovation allowance require better clarity and appropriate broadness, timely approval and more flexibility for EDBs to innovate. Refer to the discussion about regulatory sandboxes and access to innovation funds.

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<sup>30</sup> [https://comcom.govt.nz/\\_\\_data/assets/pdf\\_file/0027/278109/Final-Decision-Reconsideration-of-default-price-quality-path-for-Unison-Networks-Limited-04-March-2022.pdf](https://comcom.govt.nz/__data/assets/pdf_file/0027/278109/Final-Decision-Reconsideration-of-default-price-quality-path-for-Unison-Networks-Limited-04-March-2022.pdf)

113. There is uncertainty about the direction of consumer demands over the next decade. We need to be able to respond promptly where investment is required. Alternatively, we could use flexibility services (thereby increasing Opex costs) to manage costs which is also an uncertainty as to where DER will be deployed. We will need to respond to these uncertainties in a timely manner.
114. Reopeners should make provision for automatic triggers in the event of unprecedented inflation levels as opposed to waiting for the 5-year reset. We are currently seeing such levels of inflation which is preventing us from undertaking our entire works programme without exceeding our allowances i.e. an IRIS penalty. This will also avoid the burden of multiple reopeners being requested concurrently.

**7.43.2 the circumstances where you think this is the case, and the reasons why;**

115. Hyper-inflation, as EDBs are not compensated for the step change. In addition, the regulatory mechanisms are complex and the step change can be offset by other mechanisms to compensate for productivity (CPI-X) and WACC settings during the reset process.

**7.43.3 your assessment of the materiality of the issues and how they affect the default/customised price-path regime;**

116. There have been several material changes relating to operating costs and projects since the start of DPP3 which we could not reasonably have foreseen when the price path was set. The historical operating costs assessment when setting allowances has compounded this issue. We have seen increases in costs in materials e.g. copper and contractor labour costs over the past 2 years which have been more than inflationary increases in revenue adjustments.

### **7.43.3 how we might rethink the balance between DPP reopeners and CPPS (e.g. single issue CPP)**

117. We have discussed a few events which could result in single issue CPPs, including self-insurance risk exposure and significant events due to climate change amongst others. These events and circumstances could see the Commission receiving more reopener and CPP applications, requiring additional resources at the Commission.<sup>31</sup>
118. We submit that there should be provision in the IMs for the P-Q path to be reviewed across all EDBs from a single application where common step changes impact the majority or a significant subset (perhaps based on ICPs served) of EDBs during the regulatory period.

### **7.43.5 suggestions on simplifications and enhancements to the CPP requirements; and**

119. Orion applied for a CPP after the Christchurch Earthquake. There were a few high-level observations after the application was approved:
- In-depth investigations add extra cost, time and justification to the CPP application, especially in the case of a catastrophic event.
  - The Commission required a 10-year historical view of the costs and meeting the planned expenditure when assessing the CPP. This would be appropriate where the Commission view that the application may relate to network degradation but was less important given the disconnect to historical expenditure for forward expenditure as a result of a catastrophic event.
  - Orion was asked to provide this information for the CPP application. The cost involved in providing 10 years information was not relevant to the earthquake, and a 5-year historical costs should have been adequate for Orion's application.
  - We submit that the Commission assesses the circumstances surrounding a CPP application and tailor it to suit the reasons for the application i.e. possible network deterioration / systematic failure vs natural disasters or other future drivers of CPP applications and expenditure. This may be an area where detail of reopener consideration can be left to the DPPs.

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<sup>31</sup> <https://www.ena.org.nz/submissions/previiously-published-ena-submissions/2022-submission/document/1132>



**7.43.6 your view on whether simplification of the CPP requirements would be better achieved by setting any CPP requirements in price-quality path determinations rather than in the IM determinations**

120. The IMs are the rules (and requirements) which govern the DPPS, ID's and Price-Quality path. The requirements for the CPP should be dealt with in the IM's and any specific requirements or details about the CPP decision can be detailed in the Price-Quality determination (DPPs).

## Chapter 9 Effectiveness of the IMs for each sector

**We invite you to make submissions on specific issues you consider may fall within this topic area.**

**Submissions might relate to:**

**9.13.1 IMs that are ambiguous, contain errors or are otherwise drafted in such ways that mean they would benefit from amendments;**

121. We refer you to the ENA's submission.

**9.13.2 specific instances in which you consider that providing guidance, rather than making an amendment, would be a better approach for us to improving readability, and reasons why;**

122. We refer you to the ENA's submission.

**9.13.3 IMs that could be less complex if drafted using a flexible or principles-based approach;**

123. We recommend that the Commission review the innovation allowance to improve workability and accessibility to it, by regulated businesses.

**9.13.4 IMs that could be more workable, while still achieving their regulatory intent or outcomes, if their underlying policy were less complex; or**

124. Quality of Service- The Commission stated that *"the quality of service of electricity has seen little change, based on existing reliability measures for electricity delivered to consumers. The average consumer experienced slightly more and longer lasting outages. However, the number and duration of unplanned outages tended to be broadly stable, with the growth coming from planned outages."*

Generally, quality of service results are highly subject to extreme weather events and maintaining this during a period of COVID and increasing expectations on EDBs should be seen as admirable.

125. The introduction of notified planned outages has added administrative complexity and is covered by the Electricity Authority through the EIEP5 notification files. The Commission has observed that the

outages tended to be broadly stable. This change in 'rules', although voluntary (being an opt-in upside incentive) when DPP3 was set, appeared in the final decision paper with not too much consultation.

126. We submit that a post implementation review of the Quality of Service planned notification incentive needs to be considered and:

- Whether EDBs have been able to take up this incentive
- Had the processes in place to claim the incentive i.e. forms of auditable notifications

#### **9.13.5 policy matters that are not covered by the other topic areas set out in this paper.**

127. We have no comment regarding other topic areas.

#### **9.14 Where possible, we ask that your submission identifies the issue in terms of the text, clause or structure of the IM determination and the specific problem that flows from that issue.**

128. We have not found any issues in terms of text, clause or structure.

#### **9.15 We also invite you to:**

##### **9.15.1 suggest an approach we could take to resolving the issue (e.g., IM amendments or other appropriate regulatory changes);**

129. We have no comment.

##### **9.15.2 offer a high-level view of how the suggested approach aligns with promoting one or more of the overarching objectives of the IM Review; and**

130. We have no comment.

##### **9.15.3 describe any practical application matters related to the suggested approach (e.g., the timing of any changes relative to price-quality resets).**

131. The Commission is required to revise the IM's every 7 years. In several instances in this submission and the Commissions' draft framework paper, it is mentioned that we are in a period of high inflation along with uncertainty with the energy transition and EDBs role as an enabler for decarbonisation.

Orion would therefore welcome consideration of whether the cadence of the IM revisions is appropriate in this environment and whether the IM review should be aligned with that of DPP resets.

132. We see the 5-year cycle working well for DPP resets and would like to see this timing be adopted by the Commission going forward