28 May 2021

Andy Burgess

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Commerce Commission

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By: email regulation.branch@comcom.govt.nz

Dear Andy

Feedback on fit for purpose regulation- open letter priorities for energy networks (the Paper)

Introduction

1. Orion welcomes the opportunity to provide feedback on the Commission's open letter on priorities for energy networks and ensuring fit for purpose regulation.
2. The Commission is seeking feedback on emerging issues for our sector and is particularly interested in issues that relate to decarbonisation and use of new energy sector technologies and business models as well as the impacts of Covid-19. The Commission would like to understand our priorities for these emerging issues.
3. The Commission believes that the regulatory rules can support the increased electrification of the economy, including through incentivising innovation, the adoption of new technologies and demand response management, and allowing for the successful integration of electric vehicles.
4. The Commission is welcoming views on whether there are currently any significant barriers in either Part 4 itself or the Input Methodologies toward achieving outcomes mentioned above in points 2 and 3, and how the Commission could better support these outcomes.
5. The information provided in this feedback will inform the regulatory review of the information disclosures and the input methodologies.

Summary

6. Our future and strategy are shaped around the challenges our community face and expectations our customers tell us they have of us. Our strategy reflects where we need to lead and participate, and what we need to address as we deliver our service to them. Orion has a purpose of 'Powering a cleaner and brighter future for our communities.' It's important that regulators and regulation keep well-informed about our context.
7. The key emerging activities we have identified to support this purpose and meet customer expectations are encapsulated in six key strategic themes;
   - Being New Zealand's most advanced electricity network
   - Reimaging the future network
   - Customer inspired
   - Powering the low carbon economy
   - Lead and grow
   - Accelerating capability
8. On this basis the key emerging issues Orion seeks to highlight to the Commission are;

   General

   - the IM review process should be collaborative to ensure the right outcomes for customers
   - the Commission must carefully consider the value it puts on the enabling nature of the distribution service, on behalf of communities, as we move forward

   Sustainability and innovation

   - we support a national energy strategy and implore the Commission to 'manage up' on that basis so that the Commission's statutory objective is intergenerationally and cross-regulation fit-for-purpose, and appropriate implementation of economic regulation follows
   - we want our regulators to have legislative jurisdiction to accommodate the sustainability, innovation and efficiency related activity of regulated entities to meet community needs
   - the Commission should consider the role of NZUs, VERs and forestry to offset the carbon footprint of the regulated lines service and we seek the Commission's view on inclusion of these assets in the regulatory asset base

- a clearer incorporation of the sustainability role of EDBs in the context of electricity lines services in the innovation allowance purpose would benefit the sector and our communities, and we provide suggested wording
- consider reviewing the quantum of innovation allowance available to distributors as part of the IM review
- refine the mechanics for the innovation allowance to provide more than one application opportunity per year
- consider application to the innovation allowance based on a business case for expenditure rather than on the expectation that expenditure is completed

Advancing electricity distribution services to meet customer needs

- the inflation forecasting, and debt compensation issues raised with the Commission in April must be addressed to ensure the revenue intent of the regime is delivered and incentives to invest are maintained
- the current regulatory regime provides no reopeners for significant step changes in cost inputs that affect the sector due to Covid-19 or any other similar emergent event, and we are unsure if this event would be accommodated by a catastrophic event reopener
- an Alpine seismic event is imminent. The regulatory settings should not disincentivise distributor investment or co-investment that facilitates distributed generation to increase supply optionality for resilience
- the Commission should consider a forward-looking element to opex expenditure assessment
- the post Covid-19 uplift in overall connection volumes puts pressure on our capex allowances, people related opex and debt funding and is not coverable by any capex or opex reopeners
- penalising distributors through the IRIS for responding to customer driven needs goes counter to addressing electrification in support of decarbonisation and facilitating housing growth in a high demand environment
- to address the above two points, the Commission should consider carving out customer connection driven capex from the reset process and from IRIS. The volatility in this capex could better be accommodated with an automatic WACC based allowable revenue adjustment throughout the regulatory period based on actual capex

- the Commission must broaden its focus to recognise and acknowledge investment needed in information (including data collection and access) and systems platforms
- the Commission should consider an opex capability reopener or uplift allowance distributors can draw-down on for new capability necessary during the reset period
- reduce complexity by exclusion of website interruption notifications from Audit requirement for the planned notification incentive

Support for other feedback

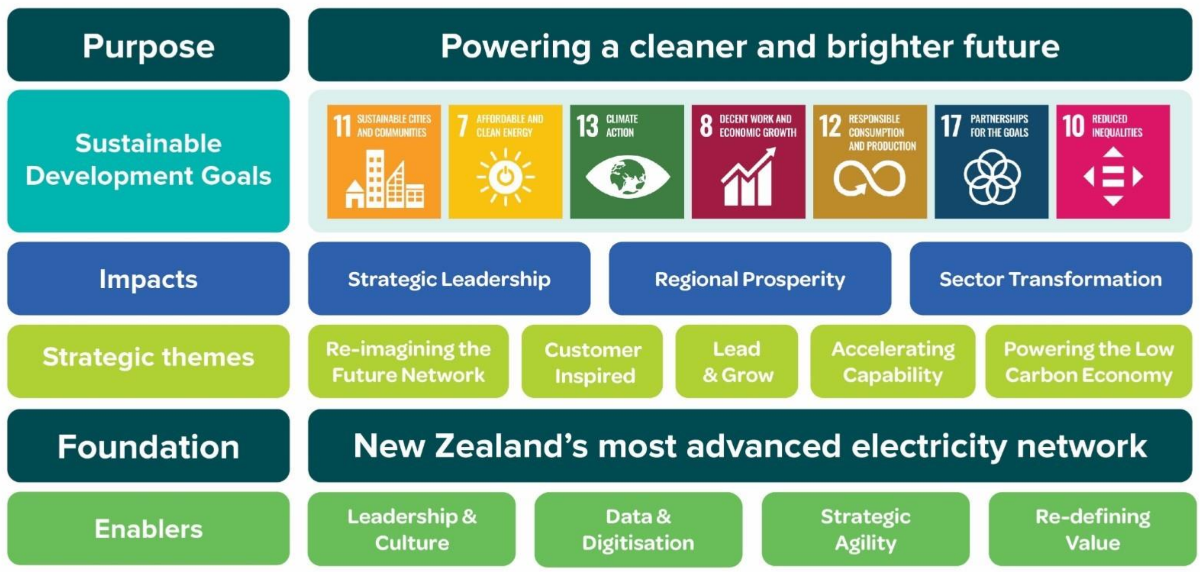
9. We support the feedback from the ENA to the Commission's open letter.

10. We have also provided feedback to the Commission in April, in conjunction with Vector, Unison, Powerco, Aurora and Wellington Electricity, with a focus on the inflation forecasting and debt compensation issues. The revenue allowance is insufficient because we are under-recovering permanently the efficient return on equity capital and it is insufficient to cover debt interest contractual obligations. This is an important focus for us during DPP3 and in relation to the DPP4 reset and is in support of other points we make in this letter.

Orion Context

11. Orion has reviewed our strategy and aspirations for the future. Our purpose is 'Powering a cleaner and brighter future for our communities' and is underpinned by a focus on selected United Nations sustainability development goals where we believe we can provide positive outcomes- sustainable cities and communities, affordable and clean energy, climate action, decent work and economic growth, responsible consumption and production, partnerships for the goals, and reduced inequalities.

12. To support our purpose, we have set our focus on five strategic programmes of work- transformation of our network for the future, customer, tackling the climate emergency and low carbon objectives to support this, optimising performance, and evolving industry capability. The foundation for our Purpose and our strategic programmes is our aspiration to be "New Zealand's most advanced electricity network".



13. We have a role to play in enhancing customer facing functions to support, share knowledge and partner with customers during the decarbonisation transition. We want to build the community's awareness about who Orion is, what services and benefits we provide them, and increase the immediacy of our conversation. We are expanding our social media presence to engage with customers and the community on the channels that are native to them.
14. This along with our targeted customer engagement through decarbonisation conversations, surveys, focus groups, sponsorships and job specific activity facilitates our connection with the community and supports our role to understand the needs and objectives of our customers.
15. Our future and strategy are shaped around the challenges our community face and expectations our customers tell us they have of us. This is what we have a part to play in addressing as we deliver our service to them. It's important that regulators and regulation keep well-informed about our context.

IM Review must be collaborative

16. We submit that the changing environment and the impact of other regulatory changes such as via the Climate Commission means the IM review process needs to be more collaborative to ensure a regime that is adaptable and agile where it needs to be, and balances complexity and pragmatism around implementation, so we get the right outcomes for customers at reset and during a regulatory period.

Long-term national energy strategy

17. We strongly support a long-term national energy strategy.
18. A strategy will encourage the type of co-ordinated approach along the energy value chain and across government, that has been lacking to date. A coherent strategy will also avoid the type of siloed behaviour that can produce inefficiencies or barriers in the low carbon transition.
19. We suggest any energy strategy should include consideration of:

- Deployment and retirement of transmission and distribution physical assets, including how to speed up this process without unintended consequences
- Interplay between decarbonisation for climate reasons and national resilience from integration of distributed generation in the community
- Facilitation of uptake of digital assets that will enable the transition
- Support for the human capital that will be required for the transition
- Release of ½ hourly energy use information direct to customers and distributors in real time

- Equitable allocation of costs at an energy system level

20.We implore the Commission to 'manage up' and advocate for a national energy strategy with a view to ensuring that the Commission's statutory objective is intergenerationally and cross-regulation fit-for-purpose. We note for instance that regulations have not been amended to consider the Zero Carbon Act.

Paradigm shift happens only with funding

21.We disagree that existing regulatory rules can support the increased electrification of the economy. The Commission must have the mandate to be more holistic, particularly in respect of the significant role and value distribution of electricity will play for our communities. The Commission must also be bold in enabling more flexible and adaptable regulatory settings that parallel the call for distributors to be dynamic, agile and responsive to the changing expectations of our communities.

22.The paradigm shift required for decarbonisation and the important role electrification has in that step change transition cannot occur without significant investment.

23.Electricity distributors must balance the funding, resources and priorities to accommodate timely preparation for, including lead times necessary to implement, decarbonisation for both process heat and transportation. It will be unrealistic not to expect borrowings to rise, capped by business treasury management policies, if we are to be responsive to customer and other third-party expectations given the relative control on revenue. Obtaining a true real return is pivotal.

24.Other jurisdictions recognise the need for flexibility in the regulatory regime. Ofgem is working with the distribution sector through its Green Recovery programme to fund the network upgrades needed for motorway service areas and key trunk road locations so they can get the cabling needed for fast charger installations. David Smith of ENA UK said "This new funding shows the social, economic and environmental benefits that can be brought forward by industry working closely with a flexible regulator."[1]

25.We submit that the Commission consider carefully the value it puts on the enabling nature of the distribution service, on behalf of communities, as we move forward.

[1] https://www.ofgem.gov.uk/publications-and-updates/ofgem-delivers-300-million-down-payment-rewire-britain?utm_source=linkedin&utm_medium=&utm_term=&utm_content=video&utm_campaign=greenrecovery240521

Powering the low-carbon economy

26. Regulators need to influence policy change to ensure that regulation can keep up with broader changes that encourage regulated entities to respond to the climate emergency. We want a regulator who is open to exploring these broader changes with an open mind that doesn't automatically preclude EDBs from participation where we can add value for good community outcomes and customer benefits.
27. We want our regulators to have legislative jurisdiction to accommodate the sustainability, innovation and efficiency related activity of regulated entities to meet community needs.
28. In July 2020, Orion released its first report on the opportunities and risks posed to its operations by climate change[2]. The report is the first of its kind produced by an electricity distributor in New Zealand.
29. In December 2020, Orion announced[3] our commitment to achieving carbon neutrality for corporate emissions by June 2022, the first electricity company in New Zealand to commit to this ambitious target. This demonstrates corporate leadership but more importantly it meets the expectations of our customers. Our research indicates that customers believe Orion has a 'product stewardship' role in the carbon footprint of the electricity it carries and delivers, and further in a 2019 telephone survey 80% of respondents were positive about Orion using native forestry to offset its operational emissions. Our customers support investment in activities that ensure carbon neutrality of the regulated service.
30. On sustainability we need a regulator that has the jurisdiction and motivation to incentivise EDB activity with clear sustainability outcomes where those outcomes demonstrate climate leadership or are desired by and benefit customers. We are concerned that while our environment has shifted, with clear requirements around management of our business carbon footprint along with enabling our customers to decarbonise, the regulatory framework that governs our economic regulation makes little recognition of these obligations and the related costs.

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[2] https://www.oriongroup.co.nz/assets/Company/Corporate-publications/2020-Orion-Climate-Change-Report.pdf

[3] https://www.oriongroup.co.nz/corporate/latest-news/orion-commits-to-carbon-neutrality-by-2022/

31.The Commission has acknowledged that it does "not have a statutory mandate in our legislation to promote the Government's climate change objectives, with the exception of an obligation to promote incentives for energy efficiency[4] when regulating electricity lines businesses"[5]. In that paper, a tenuous connection to sustainability seemed to be made by reference to innovation with a strong flavour of impending risk from participation by EDBs.

32.For New Zealand to meet its ambitious low carbon economy goals all businesses should be enabled to apply their creativity, intellect, leadership and enterprise to driving forward the urgent change needed to address our most pressing business and life risk- climate change. The Commission needs a broader statutory mandate to allow that to occur.

Allow New Zealand Emission Units (NZU's), Verified Emission Reduction Units (VERs) and forestry related to operational carbon offset on RAB

33. In our submission to the Commission levy consultation, we listed 'Our role in decarbonisation as a business in our own right (opex and capex impacts)' as a matter for consideration by the Commission.

34.To meet its climate change obligations Orion must look to manage its carbon footprint in the same way this obligation falls on all New Zealand businesses.

35.Orion is pursuing a carbon neutral program that combines NZU's, VERs and native forestry planting that our analysis suggests will be beneficial to customers resulting in lower long-term costs for them.

36. We submit that the Commission should consider the role of NZUs, VERs and forestry to offset the carbon footprint of the regulated lines service and we seek the Commission's view on inclusion of these assets in the regulatory asset base.

Innovation

Broaden purpose of innovation allowance

37.The current definition of innovation for the existing innovation allowance under DPP3 is-

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[4] Section 54Q of the Commerce Act 1986- The Commission must promote incentives, and must avoid imposing disincentives, for suppliers of electricity lines services to invest in energy efficiency and demand side management, and to reduce energy losses, when applying this Part in relation to electricity lines services.

[5] Commerce Commission briefing for the Incoming Minister- Commerce and Consumer Affairs, Digital Economy and Communications November 2020 point 65

"Innovation project means 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".

The current innovation allowance purpose is restricted to;

(a) delivering electricity lines services at a lower cost to consumers; or

(b) delivering electricity lines services at a higher quality of supply to consumers; or

(c) delivering electricity lines services at a lower cost to consumers and at a higher quality of supply to consumers

38. We encourage the Commission to broaden the purpose for the innovation allowance to encompass all three limbs of the energy trilemma. For instance, sustainability investment[6] may facilitate equity and security and/or provide other benefits that consumers value such as increased biodiversity through offsetting activities.

39. We submit that a clearer incorporation of sustainability, the third leg of the energy trilemma, role of EDBs in the context of electricity lines services would benefit the sector. We encourage the Commission to include in the purpose-

(a) improve sustainability, including carbon emissions, across business operations, in line with government and consumer expectations

(b) mitigate any remaining sustainability impacts, including carbon emissions both within direct control and within the supply chain, in line with government and consumer expectations

Increase cap on innovation allowance

40. Although it's early days in understanding the types of applications the Commission may see for the innovation allowance we believe that the current level of allowance available to each distributor may be insufficient for some innovations contemplated e.g. grid scale battery.

41. We suggest the Commission consider reviewing the quantum of innovation allowance available to distributors as part of the IM review.

[6] For example, following Australia's example, Orion implemented use of real-time hourly fire risk ratings from NIWA to manage our automated switches and stop automatic re-livening during times of high fire risk.

Refine mechanics for innovation allowance application

42. The innovation allowance is intended to incentivise expenditure in line with the purposes mentioned above. At present, an innovation allowance can only be applied for *"no later than 50 **working days** following the end of an **assessment period".*** If the Commission wishes to incentivise innovative activity our feedback is that restricting applications to a defined once per year window does not achieve this nor does it align with the agility and dynamic behaviour it is seeking from electricity distribution businesses. We would like the Commission to consider alternative application windows or the removal of an application window altogether.
43. The determination requires the expenditure related to an innovation allowance to have been spent by the distribution business before application[7]. It is likely that an application will be for the purposes of a long-term project or programme of work that could traverse several years. Requiring expenditure to be completed before application may disincentivise application and discourage the distribution business to undertake the innovative project – as there is no guarantee that any innovation fund application will be successful post spending on the project. We would like the Commission to consider application based on a business case for expenditure rather than on the expectation that expenditure is completed.
44. Some projects may require more than one specialist report to cover the breath of the activity that is to be undertaken. The Commission's rule should allow for this.

Advancing electricity distribution services to meet customer needs

45. Orion is locked into an allowance path determined by the late 2019 determination for the regulatory period 2020-2025 and each five-year period after.

Backwards assessment for opex setting not fit for purpose

46. The Commission's backward-looking approach to assessing appropriateness of distributor opex expenditure forecasts fails to accommodate the shifting nature of our environment that dynamically impacts opex expenditure during a regulatory period. The need to prove a "step change" in advance is challenging especially when it is seldom accepted even after the fact e.g. increase in traffic management costs to meet health and safety requirements. More often the increase is more gradual and incremental but no less real than a dramatic step change.

[7] Schedule 5.3 2(b)

47. We submit that the Commission should consider a forward-looking element to opex expenditure assessment.

Material cost increases and delays to equipment delivery

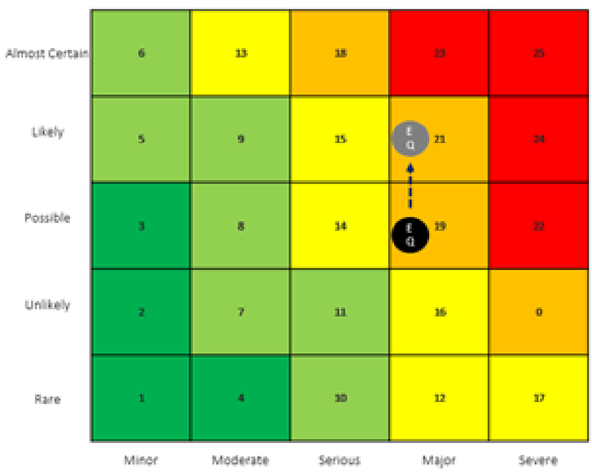
48. Delivering a safe, resilient and reliable power supply remains foundational to Orion's purpose. An immediate challenge for the sector, emerging because of Covid, is cost increases in much of our distribution equipment that uses raw materials of value such as copper, aluminium, core steel and oil. Cost increases for most raw materials are in the range plus 20-40% with copper signalling at >80%. These cost impacts erode the quantity of output we can get from our allowances - the cost to do the same work has increased.
49. In conjunction with this, we are also experiencing early indications of supply chain issues and shipping delays. An example is, we have one job requiring switchgear with an initial delivery date of November 2020 which is now May 2021. In an environment of decarbonisation and higher than anticipated connection rates this type of delay on significant work has a downstream effect on planning and field resource management. This is due to the need to push through alternative work at speed to keep service providers productive and promotes holding of additional stock levels in some areas. This challenges the output achievable within allowances.
50. The current regulatory regime provides no reopeners for significant step changes in cost inputs that affect the sector as a whole. This is particularly relevant to asset replacement expenditure where material cost escalations far exceed CPI increases during the regulatory period. We are unsure whether reconsideration of the default path as a catastrophic event per subpart 5 clause 4.5.1 could be applied in these circumstances.

Post Covid uplift in connection volumes

51.In our 2020 AMP we predicted an easing of our connection rates after the significant uplift following the Canterbury earthquakes began to slow into the end of the 2010s. Specifically, we said, in our 2019 AMP that took account of council projections, that for subdivision connection activity "Going forward, we project the total number of connections to drop from 4000 down to 3000 per annum in FY25. In our 2020 AMP update we commented that "The rate of new connections to our network has declined by 30% compared to the previous three years. This decline is sooner than we had previously forecast and has prompted us to reduce the forecast for the next three years." In practice, because of the post Covid environment, our Greenfields and brownfields residential connection rates post lockdown are increasing to levels seen in 2017 (post earthquake period). This will put significant pressure on our capex allowances, system operations and network support opex, and debt to support this unanticipated uplift in customer connection volume. None of this event generated step change is covered by a capex or opex reopener.

Resilience

52.New research findings show that the likelihood of an Alpine fault earthquake in the next 50 years is 75%, previous research had indicated a 30% chance of an earthquake in the next 50 years. We have reassessed our earthquake risk to major and likely (see heat map).



53.This new information means we are reassessing the following actions and controls;

- In an earthquake event it is essential that we can access equipment to re-establish power. To mitigate this risk, we are considering the development of pre-prepared construction response plans that will consider whether additional stockholding is necessary in any areas.
- Our AMP programme of work will be reviewed to consider any work that needs to be prioritised.
- We are considering any other mitigations or preparations possible to be put in place ahead of an event

54. Distributors are uniquely placed to partner with our communities, and target vulnerable communities, on distributed generation. The regulatory settings should not disincentivise distributor investment or co-investment that facilitates distributed generation to increase supply optionality. An example could be that 'green finance' is considered a regulated service.

Capex Reopener thresholds not meeting intent

55. Capex reopeners were introduced at the 2020 reset and we have been monitoring their applicability to upgrades, new commercial connection and process heat conversion.
56. At a high-level, the current threshold of $2m appears to be appropriate, from our perspective, for system growth projects however our experience is that an alternative approach would provide better incentives for investment in relation to customer driven new connection and capacity upgrade work.
57. We have three examples of large connections where a capex reopener was considered but could not be applied because the existing threshold is too high. The capex for these projects was in the range $0.79m to $1m.
58. The Commission should consider carving out customer connection driven capex from the reset process and from IRIS (see points below). The volatility in this capex could better be accommodated with an automatic WACC based allowable revenue adjustment throughout the regulatory period based on actual capex. Given the size of some existing coal/gas/diesel process heat operations, conversion to electricity is likely to often require significant distribution upgrade and the approach we suggest would better support this customer activity.

Remove customer connection capex from IRIS

59. Given the potential for increasing decarbonisation (process heat) conversions by customers, and the increase in and difficultly forecasting customer connections in general (see point above) we submit that connection capex be excluded from the IRIS mechanism.

60.Penalising distributors through the IRIS for responding to customer driven needs goes counter to addressing electrification in support of decarbonisation and facilitating housing growth in a high demand environment.

Exclude website interruption notifications from Audit requirement

61.In our submission to the Commission's levy consultation in January we said, "Ensure information disclosure is proportionate, outcome focussed and adds value/benefits for stakeholders, informing regulators and future regulation in line with the changing environment rather than creating an ever-increasing administrative burden that comes with its own costs."

62.The Commission introduced a planned notification incentive in its DPP3 determination. The incentive is an upside incentive with the intent of improving customer notification.

63.Orion has worked to implement the incentive over the last 12 months however we have been unable to take advantage of the incentive in our end of year SAIDI statistics. This is due to an unrealistic requirement for website posts to be evidenced (audited) and a lack of guidance from Audit NZ on how they intend to approach this aspect and what is required to meet it. This suggests that the level of prescription is too onerous for this aspect of the incentive.

64.Orion has live website information for customers on planned, current and recent outages (both planned and unplanned)[8]. The data that is posted to the website is posted at a frequency of between 60 and 120sec i.e. it is very dynamic. Because of the dynamic nature of the website posting we are unable to provide long time history (it can only be evidenced in the most recent week). To develop this would be a significant effort and cost without proportionate benefit to customers.

65.We submit that the Commission should reduce complexity by removal of the website interruption notifications aspect from the Audit requirement while retaining the certification requirement.

[8] *see https://www.oriongroup.co.nz/customers/power-outages/current*

Reimaging the future network/Data and digitisation

Importance of investment for data and information systems

66. There is an important role for the Information Solutions (IS) platform as integration with the network platform increases. IS infrastructure and tools facilitate risk management through data and information, customer service and asset stewardship through management and control of assets and future networks. This is part of our investment to deliver the network transformation roadmap.
67. Orion is currently carrying out reviews to identify (at a high level) gaps in systems, data and capability. This information will inform a review of the current trajectory, projects and priorities of Orion's information systems and the teams that support them. Outcomes in this work has the potential to improve operational efficiency and the quality of customer service.
68. This review is in service of two of the five future network programmes of work- LV monitoring programme, data platform and data insights, low voltage network visibility (ADMS[9] LV world), congestion mapping, process to incentivise non-network solutions in planning.
69. Reimagining the future network enabled by data and digitisation means that the Commission must broaden its focus to recognise and acknowledge investment needed in information (including data collection and access) and systems platforms that integrate with traditional assets to optimise performance for the benefit of customers, security of supply and sustainability.

Accelerating capability

70. Orion recognises the sector need for investment in accelerating capability given an aging workforce and the requirement for new and different skills and knowledge. There are opportunities for new business models and funding arrangements for capability development such as the Energy Academy and in progressing innovation such as the Energy Accelerator[10] both brainwaves of Orion and being delivered with key partners.[11] This is fundamental to delivering advanced electricity networks across New Zealand.

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[9] Advanced distribution management system
[10] https://www.oriongroup.co.nz/corporate/latest-news/orion-energy-accelerator-competition-calls-for-big-ideas/
[11] https://www.energyacademy.org.nz/challenge

71.The Commission should be prepared to encourage and accommodate System Operations and Network Support and Business support costs in the regulated service focussed on internships, graduate programmes and summer work experience in service of capability for existing and new roles to support decarbonisation now and into the future. This type of approach also brings fresh thinking, creativity and innovation to the sector.

72.There are new skills we will need to recruit over time such as business analysts, data scientists, community engagement and so on.

73.We submit that the Commission should consider an opex capability reopener or uplift allowance distributors can draw-down on for new capability necessary during the reset period.

Concluding remarks

Thank you for the opportunity to provide this feedback and information. We do not consider that any part of this feedback is confidential. If you have any questions please contact Dayle Parris (Regulatory Manager), DDI 03 363 9874, email dayle.parris@oriongroup.co.nz.

Yours sincerely

Dayle Parris
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