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Dear Steven

Submission on Regulatory Institutions and Practices: Issues Paper

Genesis Energy Limited welcomes the opportunity to provide a submission on the Productivity Commission inquiry into “Regulatory Institutions and Practices” and the associated issues paper.

We support the purpose of the inquiry and agree that the design of our regulatory institutions can have significant impact on the effectiveness of our regulatory regimes, and accordingly on New Zealand’s productivity.

For the purpose of this submission, our focus is on the regulation of the electricity market. We consider that this is an area where we can most helpfully contribute to this inquiry. It is also an area where improvements in design and practice will have a positive impact on economic performance and the well-being of New Zealand.

We have considered how our experience as a participant in the electricity market relates to regulatory design features identified in the issues paper. Our analysis is that there are three key areas of improvement in regulatory design that would lead to a more effective regulatory regime:

- improve the separation of rule-making from enforcement functions:

- implement more effective monitoring and review – including considering limited appeal rights,
- provide greater clarity around high level legislative objectives.

Regulatory design arrangements for electricity markets in New Zealand

New Zealand's electricity market is overseen by the Electricity Authority ("Authority") pursuant to the Electricity Industry Act 2010 ("Act") and associated regulations.

The Authority was established in 2010 under the Act as an independent crown entity. The objective of the Authority is to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers. The Authority primarily oversees the wholesale electricity market (which comprises the spot market, hedge market and ancillary markets) and the retail market. It does this through market design, overseeing market operations and monitoring and enforcing compliance with market rules. These market rules are codified in the Electricity Industry Participation Code ("Code"). Code.

Other regulators have more limited functions in relation to the wholesale and retail market, for example the ASX, Financial Markets Authority ("FMA") and Commerce Commission (in relation to competition and consumer issues).

The Commerce Commission is also responsible for the price regulation of natural monopolies, including electricity transmission and distribution businesses.

How is the regulatory regime working in practice?

Institutional and operational design features can have a direct bearing on the quality of regulatory decisions, engagement with stakeholders and overall confidence in the regulator. This in turn impacts on the decisions and behavior of market participants and, ultimately, the efficient operation of the market for the long-term benefit of consumers.

We set out in the table in **Appendix A** the Authority's design features (institutional and operational) with reference to the key regulatory features set out in the issues paper. We then discuss the features which appear to work well and the features which, in our experience, potentially work against the objectives of the regime.

The assessment in this table is based on our experience of the regulatory framework to date. We are happy to provide specific examples or further detail in relation to any particular issue.

Key recommendations and guidance for independent regulators

We understand that the Authority is a relatively new entity and that its design and operation works well in many respects. However, there are areas where the regulatory design features are problematic and do not provide participants with the requisite certainty or confidence in the regime. Accordingly, we consider that this inquiry is an important opportunity to address some of these design issues, to ensure more effective regulatory outcomes going forward.

Our review identified the following areas that any recommendations and guidelines should cover:

Separation of rulemaking and enforcement functions.

We consider that it is best practice for the critical functions of rulemaking, and enforcement, to be the responsibility of separate regulators. However, such separation may not always be practicable. In such limited circumstances, we suggest that additional guidelines are needed on an appropriate governance structure, additional transparency of decision making and information gathering, and how such information is used to inform the different roles.

Monitoring and review of regulator performance

Our experience is that more effective mechanisms are needed for monitoring the performance of independent regulators, such as the Electricity Authority. We suggest that there are three key areas where this can be improved.

- First, formal performance reviews are needed on an annual or biannual basis. This requires performance criteria capable of measurement and based on principled guidelines. Ideally, these criteria should be set and audited by an independent body. In addition to performance criteria covering the legislative objectives, criteria could include, for example, requirements relating to improved engagement and consultation, capability expectations, and stakeholder confidence (by way of surveys).
- Secondly, we see a need for independent reviews of cost benefit analysis. We consider that this in itself would have a significant impact on quality of regulatory decisions, including by incentivising the regulator to undertake more robust cost benefit analyses in the first instance.
- Third, less frequent but regular independent reviews of the effectiveness of the regime are needed – annual performance information could feed into this process.

We suggest that these functions should be performed by a suitably independent body.

Clarity of legislative objectives

Principles provided by the inquiry could cover, for example, when further direction should be provided in legislation in relation to overarching objectives. Guidance could also be provided around the role of the legislature and the role of the regulator in relation to policy development

If you would like to discuss any of these matters further, please contact me on 04 495 3340.

Yours sincerely



Jeremy Stevenson-Wright

Regulatory Affairs Manager

Appendix A: Review of electricity market regulation against design features

| Design feature | Positive aspects | Aspects that raise potential issues | Comment - impact in practice |
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| <p>Clarity of role function and duties</p> <p>The Authority was established at the same time as its empowering legislation and is a dedicated regulator of the electricity market.</p> <p>The purpose of the Act "is to provide a framework for the regulation of the electricity industry". The Authority's objective is "to promote competition in, reliable supply by, and the efficient operation of, the electricity industry for the long-term benefit of consumers".</p> <p>The Authority makes the rules in the Code and implements, investigates and enforces compliance with the Code. It also</p> | <p>As a dedicated electricity market regulator the Authority can be focused on its primary objective.</p> <p>The Authority's functions are set out in the legislation.</p> | <p>Legislative direction: The Authority's objective is broad and not supported by any further legislative direction or guidance as to how the Authority should interpret its objective or establish priorities and boundaries for its work. This means that:</p> <ul style="list-style-type: none"> • the Authority has a wide discretion as to how it implements the policy underlying the Act; and • it is difficult to hold the Authority to account or measure its performance against those objectives. <p>As an expert economic regulator, the Authority will necessarily be required to exercise judgement and discretion. However,</p> | <p>The absence of guidance around the Authority's objective has, in our view, had an impact in practice. For example:</p> <ul style="list-style-type: none"> • In the absence of such guidance the Authority has set out its own detailed interpretation of its objective (which does not necessarily reflect the underlying policy intent and / or is not necessarily soundly based).² • Because its objective is broadly worded it tends to be used by the Authority to support a preferred approach rather than guide the Authority towards the best outcome. <p>These factors can impact on certainty and</p> |

² EA paper

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| <p>investigates and enforces requirements in the Act related to industry separation.¹</p> | | <p>the legislative direction should be sufficiently clear to ensure the underlying policy objectives are achieved.</p> <p>Relevant to the above, there is a lack of clarity around the distinction between policy that is appropriate for central Government and policy that is appropriately delegated to the Authority under its statutory framework.</p> <p>Rule-making / rule enforcement: The Authority has conflicting roles where it makes the rules in the Code and enforces these rules. This is reinforced by a structure that does not distinguish between the information/resources needed to accomplish these two different roles.</p> | <p>confidence in the regime.</p> <p>In terms of the dual functions of rule making and enforcement, our observations are that:</p> <ul style="list-style-type: none"> • The Authority itself appears to conflate the roles of enforcement with market design. They quickly progress from a monitoring role to seeking to change the rules – rather than using the enforcement tools available (and thus building certainty in the interpretation and durability of current rules, and confidence that they will be objective in enforcing these rules). • The Authority has used preliminary enforcement reports to outline or suggest punitive rules for the control of “undesirable” behavior. • Information requested for the purposes of enforcement is used |
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¹ See s 16 of the Electricity Industry Act 2010 (EIA). Other functions include, undertaking market-facilitation measures, undertaking industry and market monitoring, contracting for market operation services, promoting to consumers the benefits of comparing and switching retailers.

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| | | | <p>to inform around the use of market monitoring powers (which are broad) as well as upon its rule making functions as a punitive rule making rather than undertake a clear, objective analysis of the efficiency impacts of a particular activity.</p> <ul style="list-style-type: none"> • We have also seen an increasing tendency to seek to retain discretion when amending the Code in areas where the Authority makes decisions under the Code (which means there is less certainty about how the market rules will be applied). |
| Regulatory independence and institutional form The Authority is an independent crown entity. Government policy direction must be issued by way of a policy statement under the Act and the Authority is required to "have regard to" rather than "give effect to | As an economic regulator, the Authority is appropriately independent from political intervention. It is independent in the four dimensions of independence set out in Figure 4.2 of the issues paper, albeit members of the Board are appointed by Government. | A degree of political pressure is inevitable, notwithstanding the independent structure of the regulator. We note that independence requires robust monitoring and accountability mechanisms. There is a significant gap in the framework in | We are not aware of any circumstances where the Authority's decisions and actions appear to be in response to political pressure. The Minister's power to amend the Code has not been used. |

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| <p>these statements".³</p> <p>Board Members are appointed and removed by the Governor General on advice from the Minister. The Minister must have regard to whether they have expertise in specified areas. Removal of members must be for just cause.⁴</p> <p>For a limited period, the Minister may amend the Code in relation to specific matters.</p> | | <p>this regard as discussed further below.</p> | |
| <p>Decision review and appeal</p> <p>An independent Rulings Panel is established under the Act. It can:</p> <ul style="list-style-type: none"> • hear an appeal of any decision made by the Authority under the Code; • determine complaints about breaches of the Code, including where the Authority has decided not to refer a | <p>The Ruling Panel review process appears to work well for Code breaches.</p> | <p>The Authority decisions that have the greatest impact on participants and the market are Code amendment decisions. However, appeal rights in relation to such decisions are limited to question of law appeals or judicial review. These are generally viewed as ineffective review mechanisms for decisions of an expert regulator.</p> <p>This risks poor quality decisions and adverse impacts on the market. Appeal and / or</p> | <p>Our experience over the last three years is that this issue is possibly having an impact on the effective operation of the regime (together with the absence of robust review and performance accountability mechanisms – see the discussion below).</p> <p>Our impression is that the Authority's conduct is increasingly reflecting the absence of accountably under the regime. This is particularly evident in relation to the rigor</p> |

³ See s 105 of the Crown Entities Act 2004 ("CEA") and s 17 of the EIA.

⁴ See ss 28, 29, 39 and 40 of the CEA and s 17 of the EIA.

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| <p>complaint to the Ruling Panel; and</p> <ul style="list-style-type: none"> • hears and determines disputes. <p>There is a right of appeal to the High Court of any Ruling Panel decision on points of law and full appeal rights in relation to specified decisions relating to Code breaches.</p> <p>In relation to Authority decisions, decisions made under the Code can be appealed to the Rulings Panel. Those made under the Code (for example Code amendments) are subject only to appeals to the High Court on questions of law or judicial review.</p> | | <p>decision review mechanisms correct errors and act as a discipline on the regulator (so drives better quality processes and decisions in the first instance). Appeal decisions also have precedent value and can therefore lead to better regulator decision-making over time.</p> | <p>applied to some decisions and the extent to which reasonable submissions during consultation are dismissed without good reason.</p> <p>We note that the Ruling Panel appeal process does not appear to be used for Authority decisions under the Code, possibly because key Authority decisions are not "under the Code", such as Code amendments. Accordingly, it is difficult to assess its effectiveness in this respect.</p> |
| <p>Accountability and transparency</p> <p>The Minister of Energy and Resources is responsible for oversight of the Authority, assisted by MBIE as the monitoring agency. The relevant monitoring provisions are set out in the subpart 3 of the Crown Entities Act 2004, where, among other things:</p> | <p>The Crown Entities Act 2004 sets out reporting requirements and processes for monitoring an entity's performance.</p> | <p>The accountability and monitoring provisions are not well used and / or do not appear to be effective. This may be due to the following issues with these provisions:</p> <ul style="list-style-type: none"> • Performance requirements in the SOIs are determined by the entity and tend to be high level. | <p>In our experience the lack of accountability and review processes is increasingly impacting on the effective operation of the regime.</p> <p>The quality of Code amendment decisions has been inconsistent in terms of the development of alternatives and the quality of reasoning and analysis applies, including the</p> |

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| <ul style="list-style-type: none"> monitoring performance is by way of statements of intent ("SOIs") and annual reports which must include a statement of service performance ("SSPs").⁵ the Authority determines its own performance although the Minister may require it to amend its SOI in relation to certain matters. the Minister may request a review at any time of the entity's operations and performance.⁶ <p>Financial accountability is provided for by way of the financial reporting requirements under the Crown Entities Act 2004 and Public Finance Act 1989 and the appropriation process.</p> | | <ul style="list-style-type: none"> There are no specific requirements on the monitoring agency (MBIE), no consequences for poor performance and no process for obtaining stakeholder input. In any event, it is difficult to meaningfully measure performance against the Authority's broad legislative objective in the absence of further guidance. There is no formal process for regular review of the effectiveness of the regulatory arrangements (review is subject to ministerial discretion). The Minister does not appear to use existing powers to input into and / or amend the SOI or review operations and performance. Overall the monitoring provisions do not appear to be viewed as critical or effective accountability tools. | <p>cost benefit analysis. This development is arguably inevitable in the absence of effective oversight of, and consequences for, decisions and conduct.</p> <p>As the issues paper notes, it is imperative that there is accountability for the exercise of powers. Accountability and review arrangements drive the culture of an organisation, the quality of decisions, confidence in the regime and ultimately the ability of the regime to meet its objectives. This is particularly the case where the regulator is independent and where decisions may have direct impact on New Zealand's productivity.</p> <p>Effective monitoring and review is imperative where there are limited decision review and appeals processes (see above).</p> |
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⁵See ss 137 – 153 of the CEA. The purpose of the SOI is to, among other things, provide "a base against which the Crown entity's actual performance can later be assessed". Note also that some changes to the SOI and statement of service performance requirements come into effect in July 2014.

⁶s 132 of the CEA.

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| <p>Decisions making structures processes and approaches</p> <p>The Authority is a Commission model where the Board makes the substantive regulatory decisions</p> | <p>It is appropriate for an expert Board to make decisions. However, there are areas where these arrangements could be improved.</p> <p>The Authority has recently published its strategic direction and has set out some policies in publications.</p> | <p>The current governance arrangements mean that the Board does not necessarily focus its efforts on strategic direction, and approval and oversight of operational policy or decisions. Under a Governance model there is greater differentiation between the role of the Board and decisions made (where decisions are delegated to the CEO, Board sub-committees or management depending on the nature of the decision). The Board can then hold the decision-maker(s) to account with reference to pre-declared objectives and principles.</p> | <p>The extent to which the Board focuses on strategic direction and maintains rigorous oversight of the quality of decisions is unclear.</p> <p>Recent policy publications are a welcome development but it is too early to understand how this will impact on its processes and decisions or the extent to which it will be overseen by the Board.</p> |
| <p>Overlap and consistent regulatory regimes</p> <p>There is some overlap between functions of the Authority, Commerce Commission, FMA and ASX.</p> <p>Under s 54V of the Commerce Act 1986, the Commerce Commission and Authority are required to consult on certain matters amount other things. The Authority has entered into a Memorandum of Understanding (MOU) with the Commerce</p> | <p>Overlap is relatively limited.</p> <p>Do at times appear to refer issues more appropriately dealt with by other regulators.</p> | <p>While overlap is relatively limited, the areas of overlap are in relation to important matters.</p> <p>Regulatory overlap is problematic as it can:</p> <ul style="list-style-type: none"> • impact on the quality of decisions if the decisions is not dealt with by the regulator with the appropriate expertise and focus; • create uncertainty and confusion if participants are unsure whether issues will be referred or remain within the Authority | <p>Our experience is that that Authority does not consistently refer issues to other organisations. In addition, the Authority does not appear to engage with the Commerce Commission or apply its MOU (if it does so it is not transparent).</p> <p>For example, the Authority's Transmission Pricing Methodology ("TPM") proposal clearly impacts on the Commerce Commission price control functions (be seeking to promote dynamic efficiency benefits). It is not</p> |

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| Commission | | <p>and / or if the Authority takes approaches that are inconsistent with other regulators;</p> <ul style="list-style-type: none"> • result in inefficient outcomes if regulators are taking inconsistent approaches; and • result in additional costs. | apparent that any clear division of functions has been consulted on and agreed with the Commerce Commission. |
| Regulatory workforce capabilities When selecting the Board, the Minister must have regard to member's knowledge and experience of, and capability in, the electricity industry, consumer issues, or business generally. | The Chair of the Board is recognised as an expert in electricity markets. | The Board selection criteria will not always result in the appointment of the necessary expertise required for an expert market regulator. In addition, only a small proportion of staff appear to have relevant market expertise. | The Authority is probably not yet viewed as being an expert regulator in the same way as, say the Commerce Commission. This is an issue that is potentially impacting on the quality of decisions and stakeholder confidence. |
| Engagement Under the Act, the Authority must: <ul style="list-style-type: none"> • establish 1 or more other advisory groups to provide independent advice to the Authority on the development of | The Act provides relatively specific requirements for the use of advisory groups with relevant expertise and in relation to consultation requirements. | While the Authority must consult on when and how the advisory groups are used, the decision is ultimately a question for the Authority. That is, statutory direction on the use of the advisory groups is limited. | <p>The Authority has appointed two industry advisory groups (for wholesale and retail).</p> <p>The Authority has prepared and published a charter on the advisory groups however the charter does not cover <i>when</i> it will engage advisory groups.¹⁰</p> |

¹⁰ This is contrary to the statutory requirements in s 19 of the EIA.

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| <p>the Code and on market facilitation;⁷</p> <ul style="list-style-type: none"> • prepare and consult on a charter on: how it will establish and interact with advisory groups; when and how it will consult with advisory groups on material changes to the Code; and how advisory groups must operate, including provisions concerning procedure;⁸ <p>The Authority is required to consult on amendments to the Code including on a regulatory statement that includes a cost benefit analysis and an evaluation of alternatives.⁹</p> | | | <p>The advisory group process works very well when utilised. The Authority appears to fully engage with the advisory panels, gives appropriate weight to their papers and often adopts their recommendations. However, in our view the advisory groups are not used often enough, particularly in relation to material matters.</p> <p>While engagement with the advisory groups works well, consultation with stakeholders, in our view, needs to be improved. There is an increasing perception that the Authority is unwilling to change its initial position in response to submissions. As a result, the consultation process is seen as formulaic rather than meaningful.</p> <p>This is an important issue as consultation is a key and valuable vehicle for obtaining a range of views and information that then drive the best quality decisions. Poor consultation and decision making approaches have serious</p> |
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⁷ s 21 of the EIA.

⁸ s 19 of the EIA.

⁹ s of the EIA.

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| | | | <p>implications as stakeholders are less likely to allocate resources to these processes and the quality of decisions is affected as a result. This issue also impact on confidence in the regulator.</p> <p>We note that the Authority held a conference for the first time for the TPM process. This was useful and, in our view, should be a standard step in relation to any material decisions.</p> |
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