ELECTRICITY AUTHORITY
TE MANA HIKO

8 May 2014

Murray Sherwin
Chair
New Zealand Productivity Commission
PO Box 8036
The Terrace
Wellington 6143

Dear Murray,

Regulatory Institutions and practices

The Electricity Authority (Authority) welcomes the opportunity to make a submission on the New Zealand Productivity Commission's draft report (draft report) and recommendations on how to improve the operation of regulatory regimes in New Zealand.

This submission comments on four areas of the draft report:

- the potential to improve capability by combining agencies, or combining resources
- the advantages and disadvantages of a general merits review
- comments made by submitters about the Authority
- general comments on Electricity Authority processes.

1 Improving capability by combining agencies or resources

Question 37 in the issues paper released in August 2013 asked:

> *What is the potential to improve capability through combining regulators with similar functions, compared with other alternative approaches?*

The Authority submitted that there was scope to improve the range of skills available to an agency by establishing links with other agencies, and that activities and resources could be coordinated across agencies.

The draft report recommended that:

> *Regulators should…implement cooperative arrangements with other regulators that facilitate the sharing of knowledge and resources.*

The Authority endorses the proposal for agencies to implement cooperative arrangements that facilitate the sharing of knowledge and resources.

Knowledge sharing would be enhanced by setting up formal interest groups or discussion groups across agencies on specific topics. This would raise understanding of issues that are common among regulators, and increase knowledge in the sector. There are currently a number of these interactions on an informal basis between a few agencies, and we think a more formal structure would be beneficial.

Options such as co-locating agencies, or sharing resources could achieve efficiency gains and economies of scale, leading to a reduction in costs. These arrangements would be most suitable for services such as IT, accounts payable/receivable, payroll, legal and general administrative support.

Physically re-locating agencies may not be easy to achieve due to a mismatch in the expiry of lease terms for individual agencies. Overlapping lease terms would result in some duplication of leasing costs in the short term.

An alternative to co-location would be to arrange shared services, either with or without physically relocating agencies. Support services provided within individual agencies could be rationalised as more regulators take advantage of a shared services arrangement. We expect that this would not only lead to savings but also have the advantage of greater specialisation of support staff and greater depth of support to each agency.

If support services are provided externally, costs could be expected to reduce if they were provided by a dedicated agency, and shared among regulators. Regulators who take up these arrangements should have a choice of at least three providers, so as to create competitive pressure for providing the desired service levels at least cost.

The Authority has a successful arrangement with the Commerce Commission whereby the Commerce Commission provides IT support services. The arrangement has been effective because both organisations use common IT platforms and support staff are knowledgeable on these systems.

Procedural functions are more suitable to being shared, or provided by an external agency, than functions such as HR, planning and governance. Agencies with distinct cultures, different policies and different employment contracts may not find the idea of sharing these latter services attractive or acceptable. Similarly, it would be more complex for agencies with a myriad of IT platforms and systems to share services. The short-term cost of migrating systems would have to be weighed against the potential long-term savings of a shared arrangement.

There are risks associated with physical co-location or shared service arrangements that may adversely affect regulatory outcomes. Different organisations have different cultures, attitudes to risk, and approaches to engagement. These may be positively or negatively affected by close interaction with other regulatory agencies.

For these reasons, although the Authority supports coordination of agencies, the opportunity to co-locate or share services should be assessed on a case-by-case basis.

2 Advantages and disadvantages of merits review

Question 28 in the issues paper released in August 2013 asked:

> *What are the advantages and disadvantages of a general merits review body like the Australian Administrative Appeals Tribunal?*

The Authority submitted that a general merits review body was unlikely to be any better suited to dealing with errors of law or process than the court under judicial review. In the Authority's experience, electricity industry disputes are often complex and technical, and an industry-specific body would have an advantage over a general merits review body. We also submitted that one disadvantage of the merits review process is that it would risk undermining the regulator and the decision-making process.

The Productivity Commission's draft findings were that:

- In New Zealand there is significant overlap between the scope of judicial review and appeal in practice.
- Judicial review in New Zealand is much wider in scope than in Australia, and can include greater scrutiny of the merits of decisions.
- Courts will generally defer to the decisions of expert regulators of highly complex or technical areas. In these areas of regulation, there is still a clear distinction between judicial review and appeals, and judicial review is less likely to scrutinise the substantive merits of decisions.
- In general, legislation establishing regulatory regimes does provide access to merits review of regulatory decisions.
- In areas of complex or highly technical regulation, access to merits review or the scope of appeal provided is often limited.
- It will generally be inappropriate to provide for appeals of ministerial decisions.
- Access to appeal (or merits review) should be available where it is likely to improve the quality of regulation, in terms of the objectives of the regulatory regime, taking into account the costs of providing it.
- The [Productivity] Commission has found no evidence to suggest that judicial review is an ineffective method of challenging regulators' decisions, and ensuring they act in proper, lawful, and reasonable ways.

- An absence of merits review increases the likelihood that aggrieved parties will seek recourse outside the legal system. In particular, it will encourage special pleading to politicians.
- Merits review does not offer additional safeguards to ensure decision makers followed good processes, beyond those offered by judicial review.
- The broad scope of judicial review in New Zealand means that the availability of merits review would not provide significantly stronger incentives on regulators to make correct decisions than is provided by access to judicial review alone.
- Providing access to merits review may not always promote the objectives of a regulatory regime.
- Designers of new regulatory regimes need to consider whether to provide access to merits review. In areas of highly complex, technical regulation, designers need to critically assess whether the appellate body has the institutional capability, compared to the decision maker at first instance, to improve the quality of decisions in terms of Parliament's objectives for the regulatory regime. They also need to take into account the costs and uncertainty created by providing access to merits review.
- There is no reason to believe that the incidence or complexity of appeals in areas of highly complex or technical regulation will inevitably decline over time.
- In appeals of highly complex or technical regulation, providing the court with opportunities to directly question experts, in a non-adversarial setting, can assist in understanding the issues under appeal.
- Providing courts or tribunals discretion over the admissibility of new evidence is likely to be more efficient than providing for appeals based on a frozen record.
- Foreign expertise can play a valuable role in bringing expertise to merits review of highly complex and technical regulatory regimes.

The Authority agrees with the findings of the draft report. In our view, although it is important there are adequate checks and balances to decision making, there would be little value in establishing a merits review appeal process when scrutiny by the courts is already available by judicial review.

We think the experience of the Australian Energy Regulator (AER), where a form of merits review has been available since 2008, is particularly relevant. We note the findings of the 2012 review, as quoted in the draft report, of that regime that 'there was a lack of evidence of major improvements in the way the AER conducted its activity as a result of the regime'.

We are also concerned about the finding that the AER regime had an adverse effect on consumer interests through higher network and retail energy prices, without evidence of countervailing consumer benefits.

If another form of appeal in addition to judicial review were being considered, our view is that an industry-specific body, with deep knowledge of the operation of the industry and how it operates, built up over time, would have an advantage over a general merits review body.

3 Responses to comments made about the Authority

The Authority would like to respond to four comments about the Authority made by submitters. The comments as reported in the draft report, and the Authority's responses, are shown in the table that follows.

<table>
<tr><th>Submission</th><th>Authority’s response</th></tr>
<tr><td>Electricity networks are regulated by both the Commerce Commission under Part 4 of the Commerce Act 1986 and the Electricity Industry Participation Code 2010 (code). Decisions made by either regulator often have direct implications for the functioning and effectiveness of the regime implemented by the other regulator. For example, changes to the Code which result in increased costs and/risk to distributors that were not known at the time the Commission determined the Default Price-quality Path. (Wellington Electricity)

…there have been occasions when the industry regulator has made policy recommendations that
are not aligned with the Commission’s regulatory regime. For example:

• The EA released a transmission pricing methodology (TPM) that would have given rise to volatility in transmission costs to ENBs [electricity network</td><td>The Authority does not agree with the submissions by Wellington Electricity and the Electricity Networks Association (ENA). The fact that the Commerce Commission and Authority are responsible for different aspects of electricity network regulation does not mean regulatory outcomes are worse than if they were conducted by a single regulator.

The submissions overlook:
• the statutory framework that specifies how the Commerce Commission and the Authority should interact
• the Memorandum of Understanding between the two agencies
• the ongoing interaction between the agencies on matters that may have implications for the work of each of them.

These arrangements mean that regulatory outcomes are unlikely to differ whether there are one or two regulators. Any differences in approach arise from the different legislation governing the two agencies, rather than the number of regulators.

Regarding the statutory framework, section 54V in the Commerce Act 1986 sets out how the functions of the Authority and the Commerce Commission interact. The Authority must advise the Commerce Commission of changes to the Code that would increase costs to Transpower or distributors.

The Memorandum of Understanding in place between the Authority and the Commerce Commission helps the agencies negotiate the boundaries</td></tr>
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Submission	Authority's response
businesses]. Transmission costs are a pass-through for non-exempt ENBs, and the way the DPP [default price path] is structured for pass-through costs does not allow for volatility. This meant that the proposed TPM would not work with another part of the regulatory regime; and • The EA proposed using the structure of its levy to create incentives for participants, without understanding that these are a pass-through cost for non-exempt ENBs. This means that ENBs are not directly affected by EA levies. Such disconnects between the regulatory regimes impose costs and impair overall effectiveness for no apparent advantage. (Electricity Networks Association)	between the two agencies. Under the Memorandum, the Authority and the Commerce Commission agree that: • The Commerce Commission will take into account, before exercising its powers under Part 4 of the Commerce Act, the matters specified in section 54V of that Act, and any Commerce Commission requirements relating to Transpower quality standards in a section 52P determination will be based on, and be consistent with, quality standards set by the Authority (as required by section 54V(6) of the Act). • The Authority will take into account the price-quality paths set by the Commerce Commission in relation to suppliers of electricity lines services, and the information disclosure requirements imposed by the Commerce Commission on suppliers of electricity lines services under Part 4 of the Commerce Act. • The Authority will consult with the Commerce Commission where a new or changed rule under the Code may affect determinations on price-quality and information disclosure regulation under the Commerce Act. Further, members of both the Commerce Commission and the Authority Boards meet on a monthly basis, and there are similar regular meetings at a staff level. Regarding the specific examples commented on by the submitters: • Wellington Electricity's says one example of misalignment between agencies is that changes to the Code, which resulted in increased costs and/risk to distributors, were not known at the time the Commerce Commission determined the Default Price-quality Path. In our view this

Submission	Authority's response
	is an example of a problem arising from sequential decision-making and not the number of regulators involved. It would not have mattered whether these decisions were being made by one agency or two. • The ENA's commented on the transmission costs to ENAs in a transmission pricing methodology (TPM) released by the Authority. The Authority notes, first, that it although it is consulting on proposals as part of a review of the TPM, it has not made any decisions about transmission costs. Second, as to the comment that the Authority's TPM proposal did not take into account DPP pass-through structure, the Authority specifically consulted the Commerce Commission during the development of the TPM proposal. Further, to the extent the TPM proposal raised particular issues for distributors the possible timing of introducing any new TPM meant transitional arrangements could be included to allow the Commerce Commission to adjust its DPP arrangements if needed. • The ENA is concerned about the Authority's proposal to use the structure of the electricity industry levy to create incentives for participants. The Authority fully understands that the levy is a pass-through cost for non-exempt ENBs. The Authority consulted with the Commerce Commission when it developed the proposal that involved use of the levy structure (which related to extended reserves). The Authority's view was that, for the proposal to have its intended effect, the final version of the regime depended on working with the Commerce Commission to amend the pass-through rules. The Authority would not make proposals affecting electricity networks and other industry participants whose activities are regulated by both agencies if it considered the consequential changes in the Commerce Commission's

Submission	Authority's response
	regime, required to achieve the intended effect of the Authority's proposals, were not feasible.
Genesis Energy supported merits review because "reasonable submissions are dismissed without good reasons" by the Electricity Authority.	The electricity industry is complex and technical, and the Authority appreciates contributions participants make, though submissions and advisory groups. Submissions help to ensure the Authority has all the information it needs to make decisions that meets its administrative law requirements, and are consistent with the Authority's statutory objective. The Authority Board considers all submissions, and publishes responses on its website. However, where a number of submitters make similar submissions, the Authority may respond to themes rather than to individual submissions. The Authority is required to make its decisions on good grounds, which includes considering all relevant matters. The Authority may decide not to adopt a submission, no matter how reasonable it appears to be if, the Authority finds that it is not consistent with the Authority's statutory objective, or is not a relevant consideration for the matter being consulted on.
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	Most consultation involves the release of a written paper inviting submissions, published on the Authority's website. Submissions and responses are also published there. The Authority also holds meetings and workshops with interested parties, which provide an opportunity for parties to present their views in person.

Submission	Authority's response
consultation process is seen as formulaic rather than meaningful. (Genesis Energy)	Meetings can help parties to understand why the Authority's original proposal may remain unchanged, even if a substantial number of submitters raise similar points representing the views of one or more group of submitters. Where that happens, it may indicate that the Authority needs to consider unrepresented points of view as well as those represented in submissions. Some submissions contain material that is not relevant to the matter under consideration. To be relevant, a submission must provide information or material that helps the Authority to analyse its proposition or alternatives to its proposition. The Authority would not change its position only on the basis that the majority of submitters supported or opposed the proposition. The Authority would take into account submissions that are consistent with its statutory objective, which includes considering the long-term benefits of consumers.

4 Further comments about the role of the Electricity Authority

The Authority would like to provide further comment on the distinction between its functions, and those of some other regulators.

The Authority's focus is on promoting competition and effecting pro-competitive measures through Electricity Industry Participation Code (Code) and market facilitation measures, where doing so is consistent with the Authority's statutory objective.

The statutory 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's focus on competition invites comparison with the role of the Commerce Commission, whose role under the Commerce Act is to promote competition in markets for the long-term benefit of consumers within New Zealand by prohibiting contracts or arrangements that could lead to a substantial lessening of competition, the taking advantage of substantial market power to deter or eliminate competition, and mergers or acquisitions that would substantially lessen competition.

The Commerce Commission enforces, adjudicates and provides information and advice relating to competition law generally, that prohibits anti-competitive behaviour and structures in markets.

As well as having functions related to competition, enforcement, and administration of participants in the electricity industry, the Authority's role includes the making of the Electricity Industry Participation Code, which governs participants in that industry. In this way it is different from other agencies (including the Commerce Commission) which implements but does not make legislation.

The Authority's intention in engaging with participants is to make that process as easy as possible. The Authority does this by making use of electronic access to information via its website, and by producing guidelines and guidance notes designed to help participants understand their obligations under the Code and the way that the industry operates.

The Authority has also actively participated in the government initiative to develop an online engagement service. The purpose of this service is to enhance the quality of engagement with participants by using more sophisticated engagement tools and processes. A centralised engagement service should be more efficient for stakeholders. It is expected this will be available in the 2014 calendar year.

The Authority also releases "lay-persons" guides to assist parties, especially consumer representatives, to understand Code change proposals.

Another factor that makes the Authority unusual among regulators is the extent to which it consults with participants over funding. Participants pay levies to cover the Authority's cost for the work it carries out in any particular year. The Authority consults with participants over its proposed work programme before developing a proposal for levies for the forthcoming year. Submissions are published, as is the work programme.

We trust that these comments assist your inquiry. If you would like to discuss any of the points made please do not hesitate to contact me.

Yours sincerely

Carl Hansen
Chief Executive