

Inquiry into Regulatory Institutions and Practices

Submission by
Minter Ellison Rudd Watts

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1. Introduction

- 1.1 The Commission has been asked to produce a report which provides guidance on the establishment, operation and review of regulatory regimes whilst taking into account any unique characteristics of the New Zealand operating environment.
- 1.2 Minter Ellison Rudd Watts (**MERW**) has an interest in promoting well-informed, fit for purpose regulation which is in the long term interests of all New Zealanders.
- 1.3 It regularly advises public and private sector clients on policy design, regulatory frameworks, statutory interpretation, administrative law obligations, and other public law and regulatory issues.
- 1.4 The Commission's August 2013 "Regulatory Institutions and Practices" Issues Paper (**Issues Paper**) highlights the breadth of regulatory regimes and agencies operating in New Zealand.
- 1.5 MERW is a full service New Zealand law firm, with nearly 300 employees across offices in Auckland and Wellington. Our services extend across the economic, social and environmental regulatory spectrum described in the Issues Paper.
- 1.6 However, this submission has a much narrower focus – namely the regulatory regimes which operate in the utilities sector.
- 1.7 Regulatory institutions and their practices are often considered at arms length and at a high level. However, the best lessons are sometimes learned from a "deep dive" into particular regulatory structures.
- 1.8 Our focus on the utilities sector has enabled us to provide the specific case studies and evidence based explanations sought by the Commission.
- 1.9 We expect that many of the lessons drawn from our examples will be of much broader application.

2. Scope of inquiry

Q1. What sorts of institutional arrangements and regulatory practices should the Commission review?

- 2.1 We think the institutional arrangements and regulatory practices identified in the paper are the correct ones for a review of public agencies as regulators. We note that the regulatory outcomes are also the result of the regulated parties' incentives and it might be worth examining these as well.

Q2. The Commission has been asked to produce guidelines to assist in the design of regulatory regimes. What type of guidelines would be helpful?

- 2.2 This inquiry will highlight those regimes which are simpler to implement (and sustain) than others. Guidelines on the establishment and review of new agencies will ensure that the lessons learned from the different experiences of regulators and regulated entities concerning the implementation of new regulatory regimes, are available for future legislators. It would be useful if guidelines included criteria to assess the merit of establishing a new regulatory agency. Depending on inquiry feedback, there may also be value in a review of some existing agencies.
- 2.3 Often a new agency is seen as the best solution to a new problem. This certainly enables a dedicated focus on a particular policy issue. The agency can then fall below the radar. Politicians will see the problem as "fixed" and it can be challenging to get Parliamentary time to make the statutory changes required to improve the delivery of an agency's statutory functions.
- 2.4 Guidelines might also be useful to assist regulators to effectively determine the long-term interests of consumers, if this is going to be the preferred framework for managing trade-offs between regulatory objectives. This issue is discussed further in our response to Question 7.

3. Regulatory landscape

Q3 Does New Zealand have (or need) a unique 'regulatory style' as a result of our specific characteristics?

3.1 New Zealand has a unique regulatory history in the utilities sector. This history has affected expectations about the level of regulation that utilities face, and the level of resources required to shape that regulation.

3.2 This may be changing as regulated entities come to grips with the current multi-faceted, multi-agency regulatory approach.

Light-handed regulation

3.3 New Zealand was an early adopter of utility reforms to reduce state involvement in the sector and introduce structural reform coupled with light-handed regulation.

3.4 The reforms in the mid-1980s led to a mixture of competitive and natural monopoly segments in the value chain. This in turn resulted in a need for:

(a) governance arrangements for new market structures, trading rules and systems ("market enabling" regulation); and

(b) constraints on monopoly behaviours such as prices or revenue caps, quality standards and/or third party access arrangements (regulation which "substitutes for" markets).

3.5 There have been differences in the level and pace of reforms in the utilities sector, with the result of very little consistency in approach.

3.6 A common theme in the early years was a desire to reduce the costs of regulation by:

(a) relying on general competition law as opposed to detailed industry specific regulation;

(b) using information disclosure and the threat of further regulation to constrain monopoly behaviours; and

(c) relying on industry participants to develop markets and systems without regulatory support.

3.7 These features became known as New Zealand's unique light-handed regulatory approach.

3.8 In the competitive segments of the market industry participants were successful in developing their own market arrangements and institutions, but they found it hard to:

(a) update them to address new technologies;

(b) mandate participation from all industry participants; and

(c) ensure compliance.

3.9 On some matters the network owner became the de facto regulator.

3.10 In the monopoly segments, concerns were raised by industry and consumers about the adequacy of the light-handed constraint.

- 3.11 The outcome was a series of reviews and reforms of both the regulatory agencies and the statutes under which they received their mandates, across the telecommunication, electricity and gas sectors.

Increased regulation

- 3.12 The final result has been a shift from light-handed regulation to regulation by multiple entities. This means that some of the industry participants operating in the utility sector are now amongst New Zealand's most heavily regulated entities.
- 3.13 Many corporate entities have struggled to develop and apply the resources required to manage the level of regulation they now face.
- 3.14 We are aware of clients who prepare more than 50 submissions to regulatory agencies or central government each year. This can be a significant burden for the dedicated in-house regulatory teams of the larger companies, and even more challenging for those who combine regulatory functions with planning and operational roles.

Q4. What influence has New Zealand's specific characteristics had on the way regulation is designed and operated in New Zealand?

- 3.15 An on-going driver for New Zealand's utilities regulation has been the need to find a relatively low-cost form of regulation given the size and structure of our utilities sector and our relatively small population base. This remains a valid concern.
- 3.16 An example of New Zealand's innovation to reflect this driver is the design of the price-quality path regulation administered by the Commerce Commission.
- 3.17 Section 53K of the Commerce Act 1986 (**Commerce Act**) provides that:
- “the purpose of default/customised price-quality regulation is to provide a relatively low-cost way of setting price-quality paths for suppliers of regulated goods or services, while allowing the opportunity for individual regulated suppliers to have alternative price-quality paths that better meet their particular circumstances”.*
- 3.18 In assessing current and projected profitability, the Commission uses a mixture of “generic” and customised inputs to derive a price-path for each regulated entity.
- 3.19 This is a less costly process than separately calculating and verifying for each regulated entity, inputs such as WACC, opex costs, demand growth etc.
- 3.20 It also uses “input methodologies” to promote certainty in relation to the rules, requirements and processes which apply to regulation under Part 4 of the Commerce Act¹.
- 3.21 Another example is the Electricity Authority's decision to use a model contract instead of regulated terms to guide the contractual relationship between end consumers and their retailers. The governance mechanism selected was designed to “*keep costs to a minimum*”,² amongst other factors.

¹ Section 52R Commerce Act 1986.

² See Electricity Commission *Approach to Domestic Retail Contracting Arrangements – issues and options discussion* (Consultation Paper, December 2009) at para 6 page A. However we have argued that the implementation process has actually resulted in the opposite see column by C Southey “Amending mass market contracts: Does the implementation process undercut the original policy objective?” published in *Energy News* on 2 July 2012, also available at www.minterellison.co.nz.

Q5. What other ways of categorising New Zealand's regulatory regimes and regulators would be helpful in analysing their similarities and differences? How would these categorisations be helpful?

- 3.22 Categorisation around function: policy advice, rule-making for markets, rule-making for networks, market operations, market monitoring and review, rule enforcement and consumer dispute resolution, is likely to highlight areas where efficiencies can be achieved by amalgamations across regulatory and quasi-regulatory agencies.
- 3.23 For example, both the Electricity Authority and the Gas Industry Co are involved in rule-making for domestic energy markets. They also are both involved in market operation review and monitoring. Both grant exemptions from market rules and have in-house teams which investigate rule breaches.
- 3.24 Both sectors have established independent Rulings Panels³ to enforce the relevant industry codes.
- 3.25 There are overlapping service providers:
- (a) NZX has been the allocation agent for Gas (Downstream Reconciliation) Rules 2008. It performs a similar role for the electricity market under Part 15 of the Electricity Industry Participation Code (**Electricity Code**), and also undertakes the roles of pricing, clearing, and information systems manager provided for in Parts 13-14.
 - (b) A Transpower subsidiary EMS has recently been awarded the role of gas allocation agent. It also manages the FTR market for the Electricity Authority.
 - (c) Jade Software Corporation is the registry manager for the gas industry pursuant to the Gas (Switching Arrangements) Rules 2008 and for the electricity sector under part 11 of the Electricity Code.
- 3.26 Industry participants in both sectors have co-operated to establish a joint electricity gas and electricity consumer complaints scheme⁴.
- 3.27 The regulated entities involve largely the same group of industry participants:
- (a) 98%⁵ of gas distribution services are provided by Vector and Powerco who also provide electricity distribution services; and
 - (b) 95%⁶ of gas retail services are provided by Genesis, Contact, Mighty River Power and the Todd Group, all of which are also involved in the retail of electricity. TrustPower has also recently joined this group because of its purchase of customers from Wanganui Gas.
- 3.28 A categorisation around function would highlight the efficiencies in amalgamating some of these roles.

³ Pursuant to powers in sections section 50-62 of the Electricity Industry Act 2010 and section 43X of the Gas Act 1992 and the Gas Governance (Compliance) Regulations 2008.

⁴ This scheme is discussed further in our response to Question 20 below.

⁵ By system length of owned networks.

⁶ By number of gas connections (Genesis 44%, Contact 23%, Mercury Energy 16%, Todd Group 12%).

4. Clarity of role, functions and duties of regulators

Q6. Can you provide examples of regulatory regimes with particularly clear or (conversely) unclear objectives? What has been the consequence of unclear regulatory objectives?

- 4.1 The regulatory regimes set up as a result of electricity and gas industry inquiries in the early 2000s contained “kitchen sink” objectives.
- 4.2 As a consequence, the regulatory objectives provided little practical guidance on the trade-offs which needed to be made in the regulatory process. Furthermore, the objectives on some occasions outstripped the related powers and functions. This does not enhance regulatory certainty, or credibility.

Multiple unclear objectives

- 4.3 Amendments to the Electricity Act 1992 (in 2001) and the Gas Act 1992 (**Gas Act**) (in 2004) established regulatory agencies with a long list of objectives. These were then supplemented by further objectives set out in government policy statements which the agencies had to either give effect to (Electricity Commission) or have regard to (Gas Industry Co)⁷. These objectives applied to the whole of the supply chain and were very detailed.
- 4.4 The Electricity Commission has now been replaced by the Electricity Authority which is an independent crown entity. It is no longer tasked with giving effect to government policy statements and has a much less prescriptive statutory mandate.
- 4.5 The Electricity Authority’s functions include the making and administering of the Electricity Code. The Code may promote any or all of the following:
- (a) competition in the electricity industry;
 - (b) the reliable supply of electricity to consumers; and
 - (c) the efficient operation of the electricity industry.
- 4.6 In contrast, the objectives set for the Gas Industry Co in the Gas Act have not been updated.
- 4.7 Case Study 1 provides a road map to the Gas Act objectives as supplemented by the Government Policy Statement on Gas Governance 2008 (**Gas GPS**).⁸ It shows the industry body has almost the same number of objectives as functions.

⁷ See section 172ZK of the Electricity Act 1992 as amended in 2001 and section 43ZO(1) of the Gas Act 1992.

⁸ The Gas GPS is made pursuant to section 43ZO of the Gas Act.

Case Study 1- Example of multiple unclear objectives: sections 43ZN of the Gas Act in combination with sections 7-12 of the Gas GPS.

Co-regulatory functions

Part 4A of the Gas Act establishes a co-regulatory arrangement which permits an approved industry body to make recommendations to the Minister of Energy for rules or regulations in specific policy areas:

- establishing a wholesale market, setting access terms for gas processing facilities where necessary for field development, or establishing access and upgrade arrangements for transmission and distribution pipelines pursuant to **section 43F**,
- requiring retailers to offer prepayment meters, governing customer switching, providing for customer transition in the event of a retailer insolvency, disclosing tariff information, providing meter access, regulating consumer contracts and providing for dispute resolution and compliance pursuant to **section 43G** and
- mandating a low fixed charge tariff pursuant to **section 43H**

Co-regulatory objectives

Section 43ZN provides that the industry body's principal objective when recommending rules or regulations on the section 43F policy areas is "to ensure that gas is delivered to existing and new consumers in a safe, efficient and reliable manner". Section 7 of the Gas GPS then extends this principal objective to recommendations for rules and regulations in the other policy areas in sections 43G and 43H and also to all of the industry body's non-regulatory recommendations.

Section 9 of the Gas GPS then adds two further items to the principal objective, namely "fairness" and "environmental sustainability". This gives a combined objective as follows "to ensure that gas is delivered to existing and new customers in a safe, efficient, fair, reliable and environmentally sustainable manner for all the policy areas" (although technically the industry body must follow the objective for section 43F regulatory recommendations but only "have regard to it" for the other matters.).

The industry body also has six other supplementary objectives listed in the Gas Act which apply when it is recommending rules or regulations for the section 43F policy areas. These are:

- (a) the facilitation and promotion of the ongoing supply of gas to meet New Zealand's energy needs by providing access to essential infrastructure and competitive market arrangements;
- (b) barriers to competition are minimised;
- (c) incentives for investments in gas processing facilities, transmission and distribution, energy efficiency and demand side management are maintained or enhanced;
- (d) delivered gas costs and prices are subject to sustained downward pressure;
- (e) risks relating to security of supply, including transport arrangements, are properly and efficiently managed by all parties; and
- (f) consistency with the Government's gas safety regime is maintained.

Cont'd

(Case Study 1 continued)

These six supplementary objectives are also extended to other industry body recommendations by section 12 of the Gas GPS. Section 12 also adds a further five supplementary objectives for section 43F matters and for all other policy areas:

- (a) Energy and other resources used to deliver gas to consumers are used efficiently;
- (b) Competition is facilitated in upstream and downstream gas markets by minimising barriers to access to essential infrastructure to the long-term benefit of end users;
- (c) The full costs of producing and transporting gas are signalled to consumers;
- (d) The quality of gas services where those services include a trade off between quality and price, as far as possible, reflects customers' preferences; and
- (a) The gas sector contributes to achieving the Government's climate change objectives as set out in the New Zealand Energy Strategy, or any other document the Minister of Energy may specify from time to time, by minimising gas losses and promoting demand side management and energy efficiency.

- 4.8 Neither the Gas Act nor the Gas GPS provides any weighting to the different objectives set out above, some of which are inter-related and some conflict, while others are open to various interpretations. For example:
- (a) The need for infrastructure access and competitive market arrangements is addressed in a number of the objectives.
 - (b) There is no guidance as to which is to prevail in the case of a conflict between "safety" and "reliability" over "efficiency".
 - (c) It is not clear what criteria should be applied when the objective of "maintaining incentives to invest" conflicts with the objective of "downwards pressure on price" or when "downwards pressure on price" conflicts with "full costs of producing and transporting gas are signalled to consumers".
 - (d) The requirement that "gas is delivered to existing and new customers in a... fair... manner" is very subjective and difficult to interpret: fair to whom?
- 4.9 Some of the objectives appear unachievable. For example, it is not clear how an industry body without access to gas or pipeline infrastructure can "ensure" the delivery of gas to consumers.
- 4.10 It is also difficult to see how the objective of "ensuring that gas is delivered in an environmentally sustainable manner" can be applied to the "market enabling" or "market substitution" recommendatory functions entrusted to the industry body.

Mismatch between multiple objectives and powers/functions

- 4.11 A second point to consider when evaluating the workability of multiple objectives is the degree to which multiple objectives are matched with multiple rule-making powers. This can be a greater limitation than the lack of a clear and transparent framework for managing trade-offs between objectives.

- 4.12 From a legal perspective, the definition of a regulator's function is more important than the consideration of its objectives. A regulator may only carry out its statutory functions. If a regulator wants to pursue a course of action to achieve specific objectives listed in the Act, but the action does not fall within its functions, it cannot do it.
- 4.13 The Electricity Authority has the power to develop the Code as it sees fit provided it meets the efficiency, reliability and competition criteria set out in the Act.⁹
- 4.14 In contrast, the statutory functions granted to the industry body under the Gas Act are quite narrow (although its statutory objectives are wide-reaching):
- (a) As noted in Case Study 1, the industry body may develop rules or regulations on the three section 43F policy matters **but** the Minister has a right of veto on these proposals.¹⁰
 - (b) In relation to the other policy areas outlined in sections 43G and 43H, the Minister can elect to make rules or regulations as he sees fit with the proviso that in two policy areas (customer switching and consumer complaints) he first gives the industry body a "*reasonable opportunity*" of making a recommendation before advancing his own proposals.¹¹
- 4.15 Furthermore, when considering the workability of statutory objectives and functions, a conservative interpretation of Parliament's delegation to its regulators is usually taken.
- 4.16 For example, notwithstanding the wide-ranging statutory objectives relating to access to transmission pipelines, Gas Industry Co was unable to proceed with its plans to put in place a low cost set of framework rules for the Vector and Maui pipelines in 2007.¹²
- (a) The purpose of the framework regulation was to address new entrant access rights to pipeline services, the management of separate multilateral arrangements developed by Vector and Maui pipeline owners, and the management of conflicts of interest.¹³
 - (b) However, the industry body was unable to proceed with this proposal when it was determined that the power to prescribe "*reasonable terms and conditions for access to and use of transmission pipelines*" may not be wide enough to prescribe the **principles** with which industry transmission codes must comply: only the terms themselves could be specified.¹⁴
- 4.17 These subtleties of statutory interpretation are contrary to the expectations of some stakeholders as to the industry body's role.

⁹ Section 21(1) of the Electricity Act.

¹⁰ For completeness it should also be noted that the Minister can regulate the terms of access to the Maui pipeline without receiving a proposal from the industry body (see section 43ZP(2) of the Gas Act).

¹¹ Section 43J(2) of the Gas Act.

¹² GIC "Presentation on Transmission Access" (August 2008)

<[http://gasindustry.co.nz/sites/default/files/publications/Ian_Wilson - GIC 2008 Presentation on Transmission Access.pdf](http://gasindustry.co.nz/sites/default/files/publications/Ian_Wilson_-_GIC_2008_Presentation_on_Transmission_Access.pdf)>
accessed on 2 October 2013.

¹³ GIC "Statement of Proposal: Transmission Access Framework (October 2007) <http://gasindustry.co.nz/sites/default/files/consultations/12/sop_164538.pdf>.

¹⁴ GIC "Presentation on Transmission Access" (August 2008)

<[http://gasindustry.co.nz/sites/default/files/publications/Ian_Wilson - GIC 2008 Presentation on Transmission Access.pdf](http://gasindustry.co.nz/sites/default/files/publications/Ian_Wilson_-_GIC_2008_Presentation_on_Transmission_Access.pdf)>
accessed on 2 October 2013.

Q7. Where regulators are allocated multiple objectives, are there clear and transparent frameworks for managing trade-offs? What evidence is there that these frameworks are working well/poorly?

- 4.18 In the Commerce Act, Telecommunications Act 2001 (**Telecommunications Act**), Electricity Industry Act 2010 (**Electricity Act**) and to a lesser extent the Gas Act, the framework used to manage trade-offs between different objectives, is the regulators' assessment of the long-term interests of the consumer.¹⁵
- 4.19 However, it is not clear that the regulator has any greater insight into the needs of consumers than any of the other proxies for the consumer voice e.g. retailers, consumer advocacy groups, or politicians.
- 4.20 In the utilities sector consumers are typically focussed on the outcome of the utility service – warm homes, hot water, heat for cooking and voice/data delivery – rather than the service which produces these outcomes.
- 4.21 Some regulators require regulated entities to engage with consumers as part of the regulatory process.
- 4.22 It is often not easy to get the degree of engagement from consumers necessary to provide an evidence based interpretation. Revealed preferences may differ from stated preferences and even with stated preferences, answers can differ depending on how the questions are framed.
- 4.23 Moreover, consumers do not have a single set of clearly defined needs: some will be very price sensitive, others will afford greater priority to reliability and service quality.
- 4.24 It may not be efficient to have each utility (and regulator) build “trial and error” expertise in consumer engagement.
- 4.25 It might be helpful if the Commission could produce a set of guidelines on how the complex issues associated with determining the long-term interests of consumers should be approached.

Q8. Can you provide examples of where assigning a regulator multiple functions has improved or undermined the ability of the regulator to achieve the objectives of regulation?

- 4.26 The co-location of rule-making and rule enforcement responsibilities within a single agency can raise independency issues.
- 4.27 An example where the dual role raised concerns amongst regulated entities, is the Electricity Authority's review of the undesirable trading provisions in the Electricity

¹⁵ For example:

- (a) The Commerce Commission's objectives are to:
- (i) “*promote competition in markets for the long-term benefit of consumers within New Zealand*” (section 1A of the Commerce Act); and
 - (ii) “*promote the long term benefit of consumers in markets where there is little or no competition*”...(Part 4, section 52A of the Commerce Act).
- (b) Section 18(1) of the Telecommunications Act provides that the purpose of Part 2 is “*to promote competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand by regulating, and providing for the regulation of, the supply of certain telecommunications services between service providers*”.
- (c) Section 15 of the Electricity Act provides that “*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*”.
- (d) The Gas GPS provides that the co-regulatory body should facilitate competition “*by minimising barriers to access to essential infrastructure to the long-term benefit of end users*”.

Code following the High Court's judgment on the undesirable trading situation which occurred on 26 March 2011.

- 4.28 The Authority proposed a number of amendments designed to improve the clarity of the UTS provisions and concluded, following consultation, that its proposals would provide that clarity without significantly increasing the risks to the industry participants. The cost-benefit analysis was based on its subjective assumptions in relation to these changes.
- 4.29 The majority of industry participants thought that some of the proposed changes would increase uncertainty, and further, that the proposal had the effect of broadening the Electricity Authority's powers and discretion which would weaken the rights of review related to the status quo.
- 4.30 Both views are clearly subjective: but the dialogues between the regulator and regulated parties suggest that policy credibility would have been enhanced by a rule approval process involving an independent party.

Q9. Can you provide examples of where a single agency is responsible for both industry promotion and the administration of regulations? What processes are in place to align the incentives of the regulator with the desired regulatory outcomes? What evidence is there of success or failure of these processes?

- 4.31 The Gas Industry Co has recently adopted the function to "*optimise the contribution of gas to New Zealand*", in addition to its advisory function on the regulation of gas markets.
- 4.32 The industry body's primary function under Part 4A of the Gas Act is to make recommendations to the Minister of Energy for regulatory and non-regulatory arrangements to improve the governance of the gas sector.
- 4.33 It is also required to report regularly to the Minister on "*the performance and present state of the industry*",¹⁶ to ascertain whether any further gas governance regulations are required.
- 4.34 The Gas Industry Co has adopted a strategy "*to optimise the contribution of gas to New Zealand*".¹⁷ Recently, Gas Industry Co has produced a 167 page publication entitled "The New Zealand Gas Story". The publication notes that in addition to the statutory function of reporting to the Minister on the performance of the sector against the statutory objectives, this report was also driven by:

" a request from industry participants for Gas Industry Co to play a central role in 'stitching together' the New Zealand Gas Story, to assist knowledge and understanding of gas and its role in the New Zealand economy and society."

- 4.35 In its 2013 Annual Report the Chair notes:

"While our statutory mandate is centred on the mid to downstream sectors of the industry, we are able to take a broad end-to-end, producer to customer perspective of the industry."

"During the year, the Board reconfirmed the core elements of Gas Industry Co's strategy of optimising the contribution of gas to New Zealand."

¹⁶ This is a mandatory requirements in its constitution by virtue of section 43ZL(2)(f) of the Gas Act 1992.

¹⁷ See Gas Industry Co website, <http://gasindustry.co.nz/>.

Zealand as still relevant and appropriate to the current requirements of the gas industry. In delivery our strategies we have a range of tools that are not limited to regulatory and other formal processes. They include producing information that assists industry investment decisions, adopting an industry leadership role in appropriate circumstances and facilitating industry conversations and the issues that matter.”

Q10. Are there examples where regulators have clearly defined policy functions? Conversely, are there examples of where the policy functions of a regulator are not well defined? What have been the consequences?

- 4.36 The extent to which regulators are involved in both policy-making and compliance varies across the electricity and gas sectors, depending on the agency and the nature of its statutory framework.
- 4.37 The Ministry of Business, Innovation and Employment (**MBIE**) is responsible for energy policy settings and the statutory frameworks under which the various crown entities and co-regulatory bodies operate. MBIE also receives and advises the Minister on:
- (a) Gas Industry Co recommendations for gas governance regulations; and
 - (b) Commerce Commission recommendations in relation to entities which should be subject to price control.
- 4.38 The Commerce Commission and the energy regulators are responsible for determining the rules which are required by the relevant legislation and for their administration and enforcement. The legislation has different levels of specificity about the content of these rules:
- (a) The statutory framework for the co-regulator is very detailed (Case Study 1).
 - (b) The Commerce Commission role under Part 4 of the Commerce Act is restricted to developing the operational policies (such as input methodologies), and applying the regime.
 - (c) In contrast, the Electricity Authority has extensive policy-making powers in relation to the Electricity Code, as well as responsibility for the administration of the rules it makes.

Transmission pricing example

- 4.39 In relation to transmission pricing, the transmission asset owner is given a statutory role to develop a methodology to comply with the Electricity Authority guidelines. This area could benefit from greater clarity.

Case Study 2 – The different functions of the transmission owner and the Electricity Authority in relation to the development and adoption of a new transmission pricing methodology (TPM) under the Electricity Code

Regulatory framework

The Electricity Authority and Transpower both have responsibilities in the development of the allocation methodology for the recovery of Transpower's revenues from its transmission customers under the Electricity Code. The Electricity Authority is required to develop TPM guidelines (r12.83) and Transpower is required to develop the TPM itself (r12.88).

The Electricity Authority may develop new TPM guidelines when it considers that there has been a material change of circumstances (r12.86). Transpower is required to submit its TPM within 90 days from receipt of published guidelines unless that time is extended by the Authority (r12.88). Both entities have to assess their documents against the Electricity Authority's objective in section 15 of the Electricity Act (r12.79, 12.89).

Application issues

A recent consultation process has highlighted issues around the split of roles between the Electricity Authority and Transpower.

- The Electricity Authority wishes to make extensive changes to the existing TPM. This includes an approach to transmission pricing which is not used anywhere else in the world. A recent Consultation Paper (Transmission Pricing Methodology: issues and proposals, Consultation Paper, 10 October 2012) provides significant detail about this approach. This detail prompted one industry participant to submit that the document produced by the Authority went beyond guidelines and was in fact a methodology (Vector March 2013 submission on Consultation Paper p 6).
- Separately from the statutory interpretation issue, a number of industry participants, including Transpower, have suggested that the Authority's function should go beyond the development of guidelines as its proposal involves significant wealth transfers and it is not appropriate for Transpower to be the final arbiter of design issues which have such significant impact on different industry participants.
- The timeframes for Transpower to produce a methodology under the new approach look problematic. Transpower believes it will need considerably longer than 90 days to develop a proposal. Transpower's submission suggested 12 months would be required to develop the pricing guidelines into full pricing rules, and that a further period of 12 months of parallel operation would be needed to confirm the systems are operating correctly, and to enable customers to understand how their charges change over a year (note a small retailer may have more than 3000 charge components per month) (Transpower March 2013 submission, p 9).
- The Electricity Authority and Transpower currently have different views on whether the methodology selected by the Authority is the best option available to meet the statutory objective. Transpower has released a report by its expert advisers which was very critical of the Electricity Authority's proposals (Appendix B, Transpower March 2013 submission). There is no guidance in the Electricity Code as to the process to be followed when the two agencies have different views on what the high-level statutory objectives mean in relation to a TPM.
- The Code requires the Authority to consult on the guidelines and on the methodology developed by Transpower. The Authority suggested that Transpower may not need to consult on its proposal for the TPM or may want to only consult on key details (Consultation Paper, p 163).
- As Transpower is performing a regulatory function in developing the methodology, it may take the conservative option of consulting on the methodology rather than risk judicial review from some of the industry participants adversely affected by the Electricity Authority's proposals.
- Regardless of whether Transpower has consulted on methodology the Electricity Authority (under cl 12.92 of the Code) will still need to consult on the methodology. Consulting twice on the same methodology is inefficient.

5. Overlapping and consistent regulatory regimes

Q11. Can you provide examples where two or more regulators have been assigned conflicting or overlapping functions? How, and how well, is this managed?

- 5.1 There are overlapping and conflicting regulatory functions in both the electricity and gas sectors in relation to the regulation of network businesses. This is discussed in Case Studies 3 (gas transmission) and 4 (electricity transmission).
- 5.2 These overlaps and conflicts create additional costs for regulated entities that are required to engage with different regulators operating to different timeframes on similar issues.
- 5.3 They also increase regulatory uncertainty. This is problematic for investors seeking a stable regulatory environment for the duration of their infrastructure investments.

Regulatory rules in relation to gas transmission

Case Study 3 – Regulation of transmission services by the Commerce Commission and the Gas Industry Co

- *The Commerce Commission has an interest in promoting outcomes that are “consistent with outcomes in competitive markets” and Gas Industry Co has an objective of “promoting competition” and ensuring gas costs are subject to sustained downward pressure.*
- *Both Commerce Commission and Gas Industry Co have jurisdiction over pipeline companies.*
- *Transmission and distribution pipelines are subject to economic regulation under Part 4 of the Commerce Act. This includes:*
 - *extensive information disclosure regulation designed to enable “interested persons” to ascertain if the purposes of Part 4 of the Commerce Act are being met;**
 - *regulation which establishes a default price-quality path for each entity determining the maximum revenues they can earn from the provision of pipeline services and the minimum quality standards they must meet. One of the building blocks for price-quality path regulation is a regulated entity’s expected capital expenditure on gas pipelines in the next regulatory control period; and*
 - *customised price-quality path regulation.*
- *The industry body in the Gas Act also has power to apply economic regulation on gas companies.*
 - *It can recommend to the Minister that he approve rules or regulations “prescribing reasonable terms and conditions for access to and use of transmission and distribution pipelines” (section 43F(2)(c)). This would include price and quality regulation.*
 - *In relation to transmission pipelines:*
 - *the industry body may recommend rules or regulations “requiring expansions, upgrades, or service quality improvements to gas transmission pipelines including specifying how these will be paid for” (section 43F(2)(d)); and*
 - *the Minister can regulate reasonable terms and conditions for access to the Maui Pipeline without an industry body recommendation (section 43J(1)(a)).*

Cont’d

(Case Study 3 continued)

- *Looking forward, it is conceivable that one of the transmission pipeline owners might wish to upgrade its transmission pipeline network at some time in the future. Under the current legal framework this could be approved and regulated by the industry body under the Gas Act or under a customised price-quality path application approved by the Commerce Commission.***
- *To date, the Gas Industry Co has focussed its efforts on the nature of the access arrangements which apply to the various pipelines.*
 - *Outside of its regulatory functions, Gas Industry Co has accepted separate and different roles in relation to rule change processes for the open access arrangements offered by the transmission pipeline owners.*
 - *It has also examined access and expansion issues on the Northern pipeline owned by Vector, and access issues for private pipelines in Taranaki.*

**In short, the achievement of outcomes which are similar to those which would be achieved in workable competitive markets.*

***As an aside, it is not obvious why electrical transmission networks are regulated by individual price-path regulations which provide for case-by-case consultation on major capex, but this does not apply to major capex gas pipelines.*

5.4 If the focus is on regulatory certainty and low-cost regulation, it seems problematic that there are potentially three regulators who have jurisdiction over the Maui pipeline (the Commerce Commission, Gas Industry Co and the Minister).

5.5 We note that the Maui pipeline only has twelve shippers (pipeline users).

Regulatory rules in relation to electricity transmission

5.6 Another example of overlapping roles is the regulation of electricity transmission networks. Case Study 4 provides a high-level description of the regulatory structures which apply to use of the core grid.

5.7 Both the Commerce Commission and Electricity Authority arrangements for regulating electricity transmission are new and designed to deliver long-term benefits to consumers. There is no single correct process to address grid upgrades or renewal allocation. However, it does not enhance regulatory certainty if one regulator uses an ex ante approval process for grid upgrades, and the other regulator uses an ex post process for the allocation of the costs of the same upgrades.

Case Study 4 – Regulation of transmission services by the Commerce Commission and the Electricity Authority

Regulation by the Commerce Commission

Transpower is regulated by the Commerce Commission applying an individual price-quality path.

Transpower is discussing with the Commerce Commission suitable quality or service measures for its next regulatory control period.

The Commerce Commission uses a standard building block process to set the maximum transmission revenues that Transpower is allowed to earn in each regulatory control period. There is a prescribed process for approval of grid upgrades. This requires project by project approval of capex for projects over \$20m and a separate aggregated process for approving base or minor capex every five years.

The thresholds for inclusion in base or major capex and the process for grid upgrades were developed after extensive consultation with stakeholders.

The larger projects are approved if they pass the grid investment test. Consultation with stakeholders and consideration of alternatives is required. The structure is very much an ex ante approval process based on best information available at the time.

Transpower's performance is also regulated by comprehensive information disclosure requirements.

Regulation by the Electricity Authority

The terms of its transmission services agreements are regulated by the Electricity Authority under rules 12.27-51 of the Electricity Code. These arrangements also include service measures which have the potential for overlap with the quality measures set under Transpower's individual price-quality path regulation. However, there is a legislative requirement to avoid inconsistency in the two regimes (discussed in the answer to Question 12 below).

The Electricity Authority determines how the approved transmission revenue will be recovered from transmission network users. It has developed an Economic and Decision-making Framework to guide its thinking on best practice approaches to transmission pricing methodology.

The Electricity Authority considers that there are efficiency gains available from more active participation by network users in the transmission investment decision-making process run by the Commerce Commission (October 2012 Consultation Paper).

Two of the high-ranked options identified by the Electricity Authority as being desirable for meeting this Framework (namely merchant and vote-based transmission investment pricing methods) were rejected as "cutting across the price-quality regulation of Transpower by the Commerce Commission" (ibid p129 and p132). This resulted in the Authority advancing a much lower-ranked option: a multi-part transmission methodology which includes a new "SPD method".

The SPD method allocates the costs of Transpower's regulated transmission revenues to persons who are deemed beneficiaries of transmission lines on an ex post basis. This is established by running the wholesale market's scheduling pricing and dispatch model with and without specific transmission lines to ascertain who benefits from their existence.

The Consultation Paper recommended applying the SPD method to assets built since 2004 and Pole 2 of the HVDC link. These assets were approved under a different regime, which involved ex ante assessment of the likely need for the assets. The Electricity Authority's process is not complete and its proposed use of the SPD method may change.

Q12. Are there examples of where regulators are explicitly empowered or required to co-operate with other agencies where this will assist in meeting their common objective?

- 5.8 Boundary issues between the Commerce Commission and the energy regulators are addressed in statute and also informally by way of Memoranda of Understanding (MOU). However, the arrangements fall short of a legal requirement to act jointly.
- 5.9 From a legal perspective, these statutory provisions and MOUs assist, but do not remove the costs and risks of parallel regulation.

Electricity industry

- 5.10 In the electricity industry, the interface between the Commerce Commission and the Electricity Authority is regulated by both the Electricity Act and the Commerce Act.
- (a) Section 32(2)(b) of the Electricity Act provides that the Electricity Code may not “purport to do or regulate anything that the Commerce Commission is authorised or required to do or regulate under Part 3 or 4 of the Commerce Act 1986 (other than to set quality standards for Transpower and to set pricing methodologies (as defined in section 52C of that Act) for Transpower and distributors)”.
- (b) Section 54V of the Commerce Act provides that the Electricity Authority must consult with the Commerce Commission before it amends the Electricity Code “in a manner that will, or is likely to, affect the Commission in the performance of its functions or exercise of its powers” under Part 4 of the Act.
- 5.11 An obligation to consult under s 54V is not an obligation to have a common view. Further, there is no requirement for consultation to occur in the public domain or with stakeholders. This issue was raised during the transmission pricing methodology consultation process.
- 5.12 Section 54V of the Commerce Act also provides that the Commerce Commission, when exercising its powers and performing its functions under Part 4 of the Commerce Act, must take into account:
- (a) Electricity Code provisions or decisions which affect Transpower or distribution companies;
- (b) any guidelines or directions relating to transmission agreements issued by the Electricity Authority;
- (c) electricity industry levies; and
- (d) the continuance of supply obligations imposed by section 105 of the Electricity Act.
- 5.13 The Commerce Commission is also required “if asked by the Electricity Authority to do so” to reconsider a section 52P determination and if necessary, to amend the determination to take into account the matters described above.¹⁸ A section 52P determination is a decision on which form of regulation should apply to suppliers of regulated goods or services.
- 5.14 In addition, a specific provision has been included to address the risk that Transpower has inconsistent quality standards. Thus, section 54V(6) states:

¹⁸ Section 54V(5) of the Commerce Act.

“Requirements relating to quality standards for Transpower in a section 52P determination must be based on, and consistent with, quality standards for Transpower that are set by the Electricity Authority; but the [Commerce] Commission may prescribe them in any way that it considers appropriate, as authorised by section 53M(3)”.

- 5.15 It is intriguing that this protection has not been extended to other suppliers of regulated services.
- 5.16 In addition to the statutory provisions, the Electricity Authority and the Commerce Commission have entered into an MOU which sets out the legal functions of both agencies. In this MOU both parties agree to communicate with each other and work together to minimise the scope of uncertainties regarding jurisdictional issues.
- 5.17 Importantly however, the memorandum provides that *“Nothing in this memorandum is intended to limit or affect the independence of each party or the requirement that each party act to fulfil its legal functions and obligations.”*¹⁹

Gas industry

- 5.18 The position is similar in the gas industry, where the interface between the Commerce and Gas Acts is regulated by section 55I of the Commerce Act.
- (a) There is a procedure for the industry body²⁰ to advise the Commerce Commission of recommendations, decisions and guidelines it makes or issues *“that is or are likely to be relevant”* to the powers of the Commerce Commission under Part 4 of the Act.
- (b) The Commission is required to take these matters into account when exercising its powers.
- (c) Under section 55I the Commerce Commission is also required to take into account the levy payable by any pipeline owner under the Gas Act. It should be noted that this does not, of itself, permit a direct “pass through” of the levy by regulated suppliers. From a regulated entity perspective this is not ideal.
- (d) If asked by the industry body, the Commission must also reconsider any section 52P determination it has made, and if it considers it appropriate to amend such determination.
- 5.19 These statutory provisions might preclude both regulators from setting different standards on the same topic e.g. response time for pipeline emergencies, but would not preclude them both regulating quality standards as part of their industry regulation.
- 5.20 Gas Industry Co and the Commerce Commission have also entered into a Memorandum of Understanding setting out how they will coordinate their respective roles under the Gas Act and the Commerce Act. It is essentially an agreement to communicate with each other. There is very little transparency about how it is invoked or used in practice.
- 5.21 The MOU also contains the same caveat noted in paragraph 5.17 above.

¹⁹ Clause 3 MOU Gas Industry Co Limited 5 August 2011 Commerce Commission (available at <http://www.comcom.govt.nz/the-commission/about-us/relationships-with-other-agencies/>).

²⁰ Or the Minister if he is exercising his direct regulatory powers –see definition of recommendatory body in the Gas Act.

- 5.22 It therefore falls short of a requirement to co-operate to achieve the long-term interests of gas consumers.

Q13. Can you provide examples of where two seemingly similar areas are regulated under different regulatory structures? What factors have contributed to differences in the regulatory structures?

- 5.23 An example of similar areas being regulated under different regulatory structures is the regulation of contracts for the supply of energy to residential consumers.
- 5.24 New Zealand has adopted a multi-agency approach to the regulation of energy contracts, with some elements regulated by the Ministry of Consumer Affairs and the Commerce Commission, and other elements regulated by the industry specific regulators.
- 5.25 Further, the involvement of multiple agencies has contributed to different approaches to regulation, with some regulators focussing on outcomes and others adopting detailed measures which are a mix of voluntary and legislated arrangements.
- 5.26 From a consumer perspective, it is not easy to explain why different approaches are needed.
- 5.27 For a regulated entity supplying dual fuels and working with different regulators applying different approaches and timeframes, compliance must be expensive and challenging.

Multiple agencies with multiple approaches to the same policy issue

- 5.28 There are approximately 1.68m residential electricity users in New Zealand and approximately 220,000 residential reticulated gas customers. Reticulated gas customers usually also have electricity supply so they are in fact dual fuel customers. Other dual fuel options include LPG, wood, coal etc.
- 5.29 Each consumer has similar needs from their energy supplier which are broadly:
- good information about their energy options and a choice of supplier;
 - reasonable contract terms (including price);
 - clarity about the processes for connection, metering, and disconnection;
 - efficient and accurate billing and payment systems;
 - seamless service if the supply is being offered by more than one legal entity; and
 - a process for resolving complaints and disputes.
- 5.30 Generally, the case for a regulator to intervene and/or guide the contracts which are formed between the retailer and energy consumer, arises because of the weaker bargaining power and information asymmetry of the consumer. This would appear to apply regardless of fuel source. The case for intervention in relation to the monopoly transport segment of the retail service is similar but may also be based on a desire to remove or lower entry barriers and/or reduce total supply chain costs.

- 5.31 For a number of domestic energy fuels (e.g. coal, LPG, wood etc), the only regulation is under general competition and fair trading law designed by the Minister of Consumer Affairs and enforced by the Commerce Commission. This takes an outcome-focussed approach, examining issues such as fairness of contract terms and whether the conduct leading to the contract was deceptive or misleading. In contrast, electricity and reticulated natural gas (but not LPG) are also regulated by the Electricity Authority and by Gas Industry Co under a much more prescriptive approach. The regulation extends to some but not all of the upstream suppliers for the energy product.
- 5.32 Furthermore, Electricity Authority follows a multi-faceted approach to its regulation of these contracts using a mix of governance instruments to influence the form of retail contracts.
- 5.33 As a result, retail energy contracts in New Zealand are regulated by:
- (a) high-level, output-focussed legislative terms;
 - (b) prescriptive legislative or Code requirements;
 - (c) public assessments of compliance with benchmark terms (for gas);
 - (d) public assessments of compliance with detailed model use of agreements (for electricity); and
 - (e) voluntary contracting principles (for gas distribution).
- 5.34 Case Study 5 provides further detail on the regulation which affects retail energy contracts.

Case Study 5 – Regulation of retail contracts for the supply of electricity and gas by the Minister, Commerce Commission, Electricity Authority and Gas Industry Co.

Electricity retail companies

- Will be publicly reviewed for compliance with the Electricity Authority's minimum terms and conditions.
 - The assessment criteria and process is very specific: each minimum term is broken into its component parts and each component of the relevant retail contract is assessed against a qualitative assessment of full, substantial, moderate, low, or no compliance.
 - For example, the minimum terms require a person exercising access rights to present a means of identification on arrival at a consumer's premises. If a retailer's contract required that identification be carried by such a person (but not presented) this would be assessed as partial rather than full compliance. If the retailer's practice was to always present identification on a visit but this practice was not captured in a legal document then the score would be non-compliant.
- Must be a member of a complaints resolution service.
- May comply with guidelines for dealing with vulnerable and medically dependent customers.
- Must offer a low-fixed tariff charge to consumers (section 5 of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004).

Gas retail companies

- Publicly reviewed for compliance with Gas Industry Co's benchmark terms.
 - The industry body's process is similar to the Electricity Authority's, but the benchmark terms are at a higher level with the outcome that potentially a greater range of contracts could be deemed compliant.
- Must be a member of a complaints resolution service.

Electricity Distribution companies

- Are subject to comprehensive information disclosure regulation under Part 4 of the Commerce Act.
- Unless consumer owned are also subject to price quality path regulation under Part 4 of the Commerce Act.
- Must offer a low fixed tariff charge option to retailers or direct to consumers (section 15 Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004).
- Must comply with the regulated terms of Part 12A of the Electricity Code (retailer indemnity, prudential caps, data format requirements and consultation and negotiation obligations).
- Must be a member of a complaints resolution scheme under s 96 of the Electricity Act.
- May face the risk and cost of ongoing incremental Electricity Code changes if the Authority is not satisfied with:
 - levels of compliance with distribution pricing principles; or
 - the speed of uptake of the terms of its model contract for use of system agreements.

Gas Distribution companies

- Are subject to comprehensive information disclosure regulation.
- Subject to price-quality path regulation.
- Must be a member of a complaints resolution scheme.
- Must also comply with quality and pressure regulations made under the Gas Act.
- May chose to comply with the Gas Industry Co distribution guidelines.

Electricity and Gas meter service companies

- Are not currently subject to price and quality regulation but the matter is under active review (gas metering services have been regulated previously).

6. Regulatory independence and institutional form

Q14. Are the dimensions of regulator independence discussed in Figure 4.3 helpful in thinking about New Zealand regulators?

- 6.1 We agree that adequate funding, secure tenure, an efficient rule-making process, and a structure which enables the regulator to be free from stakeholder interference,²¹ are important dimensions for achieving regulatory independence.
- 6.2 Often the empowering statute will have rules relating to the independence of the governing board. In addition to these requirements the principles of natural justice will apply unless expressly and clearly excluded.
- 6.3 Thus it is also important to separately consider the administrative law requirements which apply to persons exercising public law functions, irrespective of whether they are a public or private body.²²
- 6.4 These rules require the decision-maker to avoid both pre-judgement and bias and the appearance of pre-judgment and bias in their decision-making.
- 6.5 The principles are often considered to require freedom from pecuniary interest. In fact, they extend well beyond financial interest and include any situation of bias, e.g. a situation where there was evidence of a “closed mind” or a close association which a reasonable person would consider would affect the decision-makers’ impartiality.
- 6.6 In some circumstances a court could hold that the participation of an interested person could taint:
- (a) the whole process of developing the relevant rules and regulations; and
 - (b) administrative decisions pursuant to those rules and regulations.
- 6.7 The goal is policy coherence and stakeholder credibility over the long term. To achieve this, what is really being sought is the best environment possible to create independence of mind.

Q15. Which of these dimensions of independence is most important to ensure a regulator is seen to be independent?

- 6.8 We think they are all important. It is not hard to think of examples under each head which would have a serious adverse impact on the ability to deliver a stable and coherent regulatory regime.

²¹ In this context we would see “interfering stakeholders” as anyone who had short-term objectives whether they are politicians, regulated entities, service providers or advocacy groups.

²² This includes (i) industry bodies making recommendations on sector rules to a Minister; (ii) industry bodies or crown agencies proposing market facilitation measures or industry agreements as an alternative to rules and regulations and (iii) network owners amending their access codes or performing other public functions.

Q16. Can you provide examples where a lack of independence or too much independence according to one of these dimensions undermines the effectiveness of a regulatory regime?

- 6.9 There are successful examples in both the electricity and gas sectors of the industry being involved at governance level in the development of new market rules.
- (a) Given the highly technical nature of the rule-making activity and the need for rapid progress, the involvement of the industry was an important pre-requisite for success.
- (b) However, the history of energy regulation in New Zealand suggests this is more likely to apply to “market enabling” regulation than regulation which substitutes for markets.
- 6.10 We also consider the involvement of regulated entities in market administration. We are less persuaded that this is needed.

Industry involvement in policy design

- 6.11 As noted in response to Q3, energy reforms led to a need for the industry to develop arrangements to address a number of complex interfaces so competition can occur at the retail and wholesale levels. These interfaces are summarised in the following diagram.

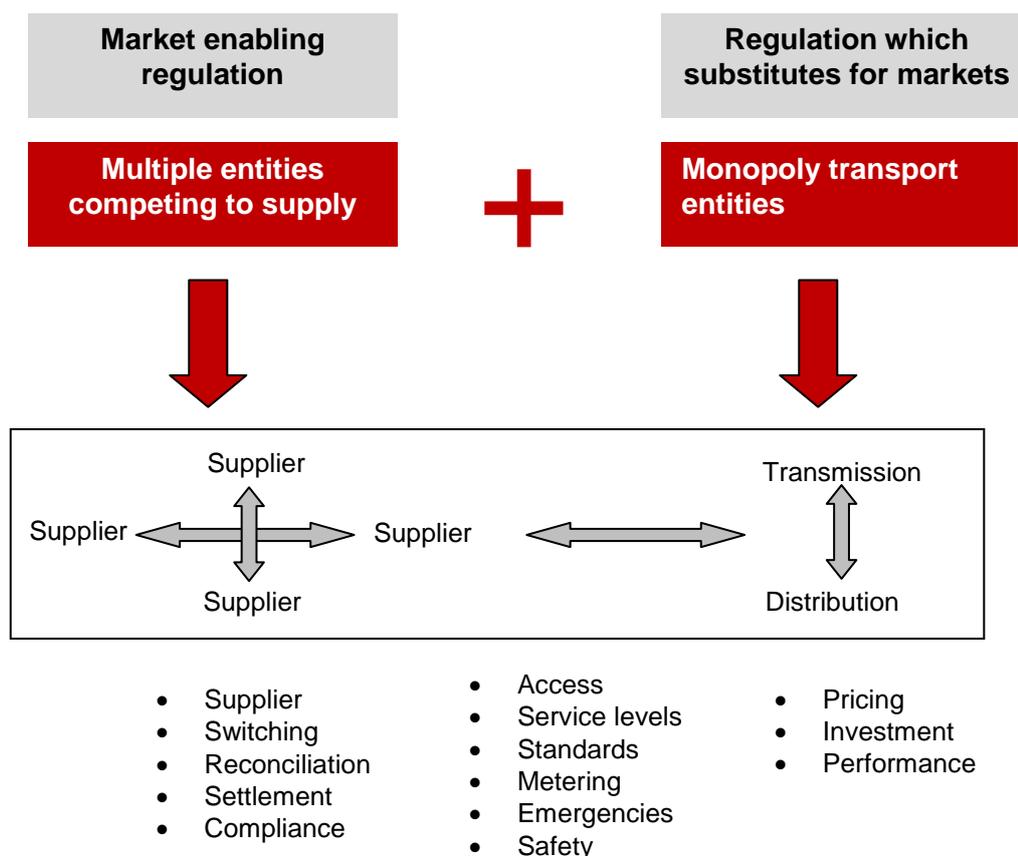


Figure 1

- 6.12 The industry was extensively involved in the design of these new arrangements in both electricity and gas. This was an efficient way to deliver the required technical expertise and an important pre-requisite for success.

- 6.13 For example, in the electricity sector's seven year period of self-regulation, the industry successfully:
- (a) developed metering and reconciliation arrangements in 1994;
 - (b) designed a wholesale electricity market in 1996;
 - (c) achieved multilateral agreement on common quality standards in 1999; and
 - (d) completed a project to bring these three sets of arrangements into a single rulebook in 2000.
- 6.14 Similarly, in the gas industry, the co-regulatory model was adopted as an alternative solution to electricity self-regulation. It has been effective in utilising industry resources to develop arrangements for downstream reconciliation, customer switching, critical contingency management and compliance.
- 6.15 However, in both sectors the ability of the industry to agree arrangements to govern monopoly transport entities has been less straightforward. For example:
- (a) Disputes about pricing with Transpower in the mid-1990s led to amendments to the Electricity Act 1992 to mandate a pricing methodology.
 - (b) The industry were unable to reach agreement on the transport sections of an industry rule book in 2000, which was a key contributing factor to the failure of proposed self-regulatory model.²³
 - (c) In 2010 the Minister did not agree with the Gas Industry Co's recommendation for regulation, for a single balancing regime across both transmission pipelines because of lack of industry support. This proposal has now been withdrawn.
- 6.16 These examples lead us to conclude that for network industry regulation, a greater level of independence (from both government and regulated entities) may be required.

Industry involvement in market administration

- 6.17 We have also considered the extent to which the industry should be involved in the administration of market rules. For public law reasons we think it is preferable if market administration is conducted at arm's length from the industry.
- 6.18 An example of a regulatory regime where this has had to be addressed is the co-regulatory regime in the gas sector. This is discussed in Case Study 6.

²³ A fuller explanation of the failure of electricity self-regulation can be found in the article by D Caygill "Why did Electricity Self-Regulation Fail" Yearbook of NZ Jurisprudence p 20.

Case Study 6 – Industry body’s market administration roles

- *The downstream reconciliation, customer switching, critical contingency management, and compliance regulations give the Gas Industry Co a number of market administration roles. For example:*
 - (a) appointing and managing service providers;*
 - (b) establishing various fees paid by industry participants;*
 - (c) determining technical matters such as information exchange file formats, accuracy requirements, gas usage profiles, contingency imbalances etc;*
 - (d) appointing and managing auditors and industry experts to undertake various defined functions under the rules;*
 - (e) deciding information requirements and publishing information for the industry;*
 - (f) approving contingency plans of pipeline operators;*
 - (g) granting and managing rule exemptions; and*
 - (h) investigating and assisting in the resolution of rule breaches.*
- *The board of the Gas Industry Co is elected by the industry shareholders and includes directors without material interests in the gas sector, and also directors of current industry participants (usually the CEOs).*
- *To maintain approved co-regulatory status the majority of directors must not have a material interest in the gas industry. This is defined in the negative:*

*“A member of the board is not **independent** if that person -*

 - (a) has a material financial interest in an industry participant;*
 - (b) is a director, officer, member, employee or trustee of an industry participant; or*
 - (c) is otherwise directly or indirectly materially interested in an industry participant.”*
- *Gas Industry Co has formed a board subcommittee of the non-affiliated directors to make decisions on matters where there are issues of conflict. This committee may be required to make decisions about matters affecting other board colleagues or their competitors (albeit mostly on matters of a minor or technical nature).*

Q17. What should be the limits of regulator independence? What sorts of regulatory decisions should be the preserve of Ministers rather than officials?

- 6.19 A balance needs to be struck between establishing regulators with the independence necessary to fulfil their statutory functions in the long term interest of the public, and ensuring there is appropriate accountability to that public.
- 6.20 There is merit in providing that there is an ex ante scrutiny of regulatory decisions which have:
- (a) a material effect on the rights and interests of individuals;
 - (b) a material impact on a particular group e.g. wealth transfer between industry participants; or which involve
 - (c) significant matters of general principle.

- 6.21 One way this can be accommodated is by including the relevant Minister in the regulation making process. An example of this is the process for imposing price control on particular goods or service. This involves:
- (a) the Commerce Commission holding an inquiry as to how and whether to regulate the particular goods and services (which can be initiated by either the Minister or the Commission);
 - (b) the Commerce Commission making an independent recommendation on the outcome of the inquiry; and
 - (c) the Minister considering the recommendation and deciding whether or not regulation should be imposed.²⁴

Q18. Do you agree with the list of features in Figure 4.3 which indicate a need for more or less regulatory independence? What other criteria are missing?

- 6.22 We agree that the list of features in Figure 4.3 provides a good guide to the required level of regulatory independence. Applying this criteria to the energy sector, suggests that institutional independence should be an important feature of the regulatory environment.

Q19. Is regulatory capture more or less likely in a small country? Can you provide examples of capture in New Zealand?

- 6.23 The current Electricity Code was developed by the industry coming together to create market rules to enable competition following structural reform in the mid-1990s.
- 6.24 As you would expect, the focus of the industry participants at this time was on developing the matters needed to trade (at both the wholesale or retail level) rather than on the matters of concern to end users.
- 6.25 In the past there has been criticism of the fact that the Code is dominated by matters relevant to the supply side rather than demand side or end users.
- 6.26 These factors are primarily explained by the development history.
- 6.27 Going forward, we think that all stakeholders need to be vigilant about the regulatory process to minimise capture risks. New Zealand still has a young history in terms of engagement with the regulatory process. However, it is acknowledged that there are resource issues for some stakeholders (e.g. groups representing the policy interests of domestic consumers).

Q20. Are there any other institutional forms for government established regulators?

- 6.28 The Electricity and Gas Complaints Commissioner Scheme (**EGCC**) is an industry scheme established to meet statutory requirements. These requirements were originally set out in successive government policy statements but are now recorded in statute.

²⁴ Section 52E Commerce Act.

- 6.29 Importantly, section 43E of the Gas Act and section 96 of the Electricity Act require retailers and distributors in both industries (and Transpower) to be members of the specified scheme.²⁵
- 6.30 Key features of the scheme include:
- (a) A Complaints Commission with a board comprising consumer representatives, industry representatives, and an independent chair. The Complaints Commission oversees the work of the Commissioner and the EGCC Office in dealing with complaints and making determinations.
 - (b) A Commissioner as the principal decision-maker, who takes overall accountability for all determinations.
 - (c) An EGCC office to provide support for the Commissioner. Conciliators located within the EGCC Office to handle complaint enquiries, mediate disputes in the first instance, and support the Commissioner in any determination.

Q21. Do particular types of institutional form lend themselves to more enduring regulatory regimes?

- 6.31 As most of New Zealand consumes utility services, politicians are very sensitive to price and service levels. This, combined with a unicameral system, means that New Zealand has had a number of legislative changes to its utilities regulation. These changes have included both changes to institutional form and to the statutory mandate.
- 6.32 For the reasons noted in response to Q3, we think the regulatory process is still new in New Zealand and as a consequence is still establishing its legitimacy.
- 6.33 We suspect that the key to a stable and enduring regime lies not so much in the form of the institution, but in gaining greater stakeholder acceptance of the role and purposes of regulation, and of the toolbox regulators have to deliver the desired objectives.
- 6.34 The electricity sector has had various self-regulatory arrangements, followed by the Electricity Commission and then the Electricity Authority.²⁶
- 6.35 This pattern of change to institutional form in the electricity sector looks likely to continue. Current opposition parties have recently announced policies which would involve further reform of sector governance, including the replacement of the Electricity Authority with a new crown entity NZ Power, who would:
- (a) set electricity policy (currently undertaken by MBIE);
 - (b) regulate lines businesses (currently undertaken by the Commerce Commission);
 - (c) bring the Electricity Authority's outsourced market service provider functions in-house;
 - (d) purchase new generation; and

²⁵ See clause 4 of Schedule 3 of the Electricity Act.

²⁶ The Ministry for Business Innovation and Employment's website lists a chronology of electricity reforms which have occurred from the mid 1980s to June 2012. <http://www.mbie.govt/>.

- (e) act as the single buyer of wholesale electricity, setting purchase prices based on cost recovery.²⁷

6.36 Gas Industry Co appears to be well supported by the industry and has recently acquired three new members. However, at least at a theoretical level, similar outcomes are possible as the co-regulatory regime can be disestablished:

- (a) by a sufficient number of shareholders deciding that they wanted to disestablish their industry body; or
- (b) by the Minister of Energy, if he has consulted with the industry body and either decides to replace it or is satisfied that the industry body no longer meets the criteria for approval specified in the Gas Act (for example that it is not representative of the industry).²⁸

6.37 We note the Commerce Commission has been established for 19 years although there have been changes to the primary legislation it administers:

- (a) In 2001 the Commerce Act was amended to introduce a targeted control regime (price-quality thresholds).
- (b) In 2008 this regulation was replaced by default/customised price-quality regulation or individual price regulation.

Q22. What are the key differences of institutional forms in terms of their regulation, operational, institutional or budgetary independence?

6.38 The following table answers this question by way of comparison between the Gas Industry Co and Electricity Authority, and Commerce Commission.

	Commerce Commission	Electricity Authority	Gas Industry Co
Discretion to regulate	Develops input methodologies, guidelines and processes to achieve purposes of legislation.	Able to amend code to achieve statutory objective.	Recommendatory powers on range of specific matters. On a number of matters the Minister can proceed without recommendation.
Operational decision-making	Various statutory roles and functions entrusted to it under the Code.	Various statutory roles and functions entrusted to it under the Code.	Various statutory roles and functions entrusted to it under rules or regulations. Non-affiliated directors decide some matters.
Budgetary independence	Funded through annual appropriation process.	Funded through annual appropriation process and annual levies set by regulation.	Funded through annual levy which needs to be agreed by board (which includes major levy payers) and the Minister.

²⁷ See Labour Policy Document available at <http://www.labour.org.nz/nz-power>).

²⁸ Section 43ZM(2) of the Gas Act.

	Commerce Commission	Electricity Authority	Gas Industry Co
Institutional independence.	Independent entity.	Crown Independent entity.	Private company. Directors elected in accordance with constitution which is approved by the Minister as a condition of co-regulatory status.

Figure 2

Q23. Are there aspects of regulatory independence that are more or less important in regulating state power or government provided/funded services?

6.39 We think freedom from bias is the most important criteria. This applies to regulated entities irrespective of whether they are inside or outside the state.

7. Decision-making structures, processes and approaches

Q24. Are there other types of governance structure than the three listed above? How well do they work?

- 7.1 We are not aware of any other decision-making model. We support the delegation of routine tasks to a Chief Executive or other staff member where the subject matter is not particularly complex and the decisions and criteria for the decision have been clearly established by the Board.
- 7.2 We suspect that in practice, on highly complex technical areas there is a level of convergence of the governance board and commission models.

Q25. What type of governance and decision-making structure areas are appropriate for different types of regulatory regime?

- 7.3 We think that a multi-decision-making model best suits the regulated industries environment where decisions require a mix of economic, financial, commercial, engineering and legal knowledge.
- 7.4 For this to be effective, in practice there needs to be the right culture in the board room. This includes a forum which encourages constructive debate with each other, staff and advisers.

8. Decision review and appeal

Q26. How effective and consistent are the review and appeals processes provided for in New Zealand regulatory regimes?

- 8.1 We think that it is important that a regulator's actions are subject to appeal and review in the Courts.
- 8.2 In our experience, the Courts are willing to review decisions which have a "public element" provided there is an appropriate criteria that can be applied in the review process. Decisions with a high policy content will usually be found to be non-justiciable.
- 8.3 Review and appeals processes in the electricity sector primarily occur where there is significant revenue at risk for the appellant such as:
- (a) the allocation of transmission charges between grid users; and
 - (b) the determination of various parameters which affect transmission and distribution revenues (e.g. asset value or WACC determinations).
- 8.4 These processes can be the only review avenue available to stakeholders who are subject to significant adverse change. For example, a change to the recoverability of costs of investments made under a previous regime.

Q27. Can you provide examples where the review and appeals processes provided for are well matched or poorly suited to the nature of the regulatory regimes?

- 8.5 The new regime for economic regulation of electricity and gas network businesses has been subject to a large number of appeals.
- 8.6 Successful appeals against the input methodologies could result in the Commerce Commission being required to update its default price-quality path and customised price-quality path determinations for the current regulatory control period.
- 8.7 However, the Commission may change the input methodologies and/or parameters for the next regulatory control period.
- 8.8 The Commerce Commission has publicly expressed its disappointment on some of those appeals.
- 8.9 It is too early to ascertain whether the appeal process will be a consistent feature of the regime or whether it is merely the bedding in of a new regulatory process.

Q28. What are the advantages and disadvantages of a general merits review body like the Australian Administrative Appeals tribunal?

- 8.10 Any appeals process will need to follow a set of rules to ensure that it gathers and tests evidence appropriately and is fair to all appellants.
- 8.11 There can be benefits in having an expert body developing expertise over a range of similar decisions, particularly in a highly technical field.

- 8.12 There can also be benefits in a more streamlined process, for example, if the courts conducted a more inquisitorial process to speed up the production of evidence.
- 8.13 The changes could be achieved within the existing court system or by creating a dedicated appeals body.

9. Allocation of risk through the regulatory system

Q29. Can you provide examples where risks are borne by a regulator, regulated party, or the public/consumers, but they are not best placed to manage those risks?

- 9.1 This can occur when the regulation of different parts of the supply chain is poorly aligned, including when related regulation is introduced at different times.
- 9.2 For example, electricity retailers were made responsible for breaching the acceptable quality guarantee in the Customer Guarantees Act, when the Act was adopted in 1993. However, they did not have the benefit of an indemnity from distributors and Transpower as a consequence of these breaches, due to events or conditions on the distributors or transmission owner's network. This has been partially addressed by changes to the Electricity Code and will be further addressed when amendments to the Act are made.

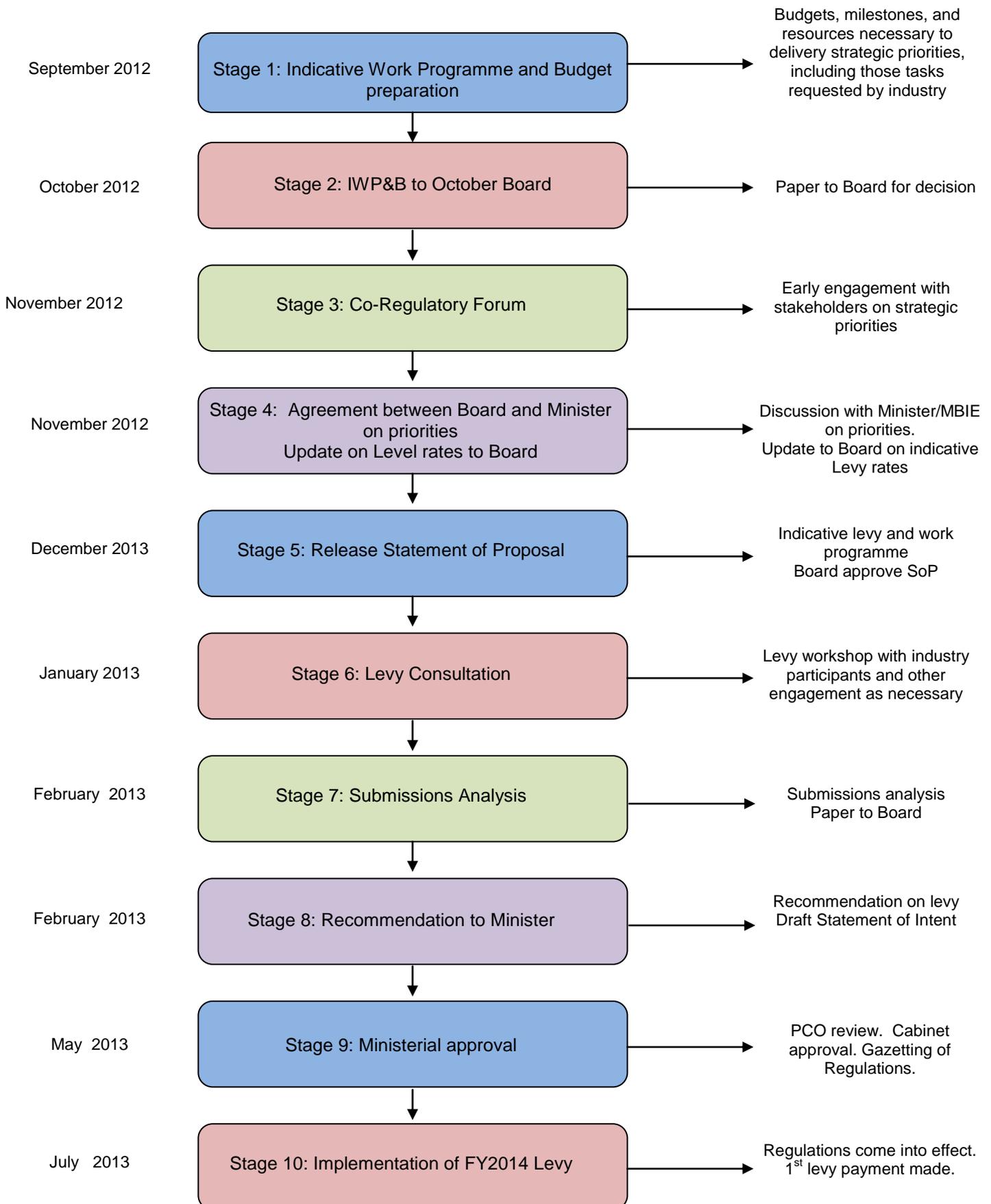
10. Funding and resourcing

Q30. Can you provide examples of where the mix of funding sources contributes to the effectiveness or ineffectiveness of a regulatory regime?

- 10.1 We think it is appropriate to fund the activities of the industry specific regulators by a levy on the industry. However, it is not always efficient to do this at a granular level.
- 10.2 Gas Industry Co is funded by a mix of sources. It receives:
- (a) a membership contribution of \$5,000 per shareholder (which is held for contingencies);
 - (b) an annual levy to cover the costs of its policy and market administration under specific regulators (\$4.6m in FY2013); and
 - (c) market fees to cover the costs of service providers and consultants' specific regulations (\$1.4m in FY 2013).
- 10.3 The annual levy has two parts: a retail levy based on customer ICPs and a wholesale levy based on purchased gas volumes. According to the Gas Industry Co's annual report, the retail level is relatively predictable but the wholesale levy "*can fluctuate significantly depending on the weather*". Between FY2012 and FY2013 the report noted this difference was 10%.
- 10.4 It may be more efficient to have the same levy structure for the recovery of all of the co-regulatory body costs including those of its service providers and consultants. We imagine the costs of the industry body do not fluctuate with the weather.
- 10.5 In addition, we note that the requirement to get both industry and government approval for the annual levy creates a long-winded process for each year's funds. This is depicted in Figure 3 (sourced from the Gas Industry Co website).

Figure 3

Levy setting process FY2014



Q31. Is the mix of funding sources for individual regulators consistent with their stated funding principles?

10.6 See comments above.

Q32. Which New Zealand regulators (or regulatory regimes) provide good examples of open and transparent funding arrangements? Can you provide examples of where the transparency of funding needs to be improved?

10.7 We think the Electricity Authority and Gas Industry Co provide good information about their future work programmes and associated costs. However, because this is provided in different forms it can be difficult to draw comparisons between both agencies which have similar functions.

Q33. Can you provide examples where a regulators funding arrangements support or undermine its independence?

10.8 The need for separate approval from the industry and the Minister creates room for a variety of influences on priorities under a co-regulatory model.

11. Regulator workforce capabilities

Q34. What approaches are there in identifying, building and maintaining workforce capability? How effective have they been?

- 11.1 The functions of regulatory agencies change over time: an agency may start with a strong emphasis on standard setting or rule-making and then have the balance of its work migrate to administration, monitoring and enforcement functions.
- 11.2 For a new agency, it may be appropriate to use external consultants or fixed term employees until its steady state organisation requirements are known.
- 11.3 Once a steady state is arrived at, it is important that staff have the same opportunities for learning, growth and development as are available in other roles. This can be challenging for small agencies.

Q35. What restrains or enables a regulator to develop the capability they need in the New Zealand context?

- 11.4 We support regulatory agencies having the resources they need to discharge their statutory duties. A mix of professional skills is required including economic, financial, commercial, engineering and legal skills, combined with a productive and collaborative team environment.
- 11.5 It is often claimed that a lack of funds has an adverse impact on regulatory agencies' ability to attract and retain resources at both board and executive level. Figure 4 sets out the board and executive remuneration extracted from the 2013 annual reports of the Gas Industry Co and the Electricity Authority, and the 2012 annual report of the Commerce Commission. Salaries at these levels would not appear to provide any restraints for these agencies developing the capability they need to achieve their statutory functions.

Figure 4: Employee Remuneration at Gas Industry Co and Electricity Authority

GAS INDUSTRY CO		ELECTRICITY AUTHORITY		COMMERCE COMMISSION	
Directors	\$	Directors	\$	Directors	\$
Chair	93,500	Chair	230,000	Chair	468,000
Deputy Chair	63,360	Deputy Chair	-	Deputy Chair	337,000
Independent Director	54,600	Director	68,000	Commissioner	382,000
Independent Director	52,800	Director	85,000	Commissioner	125,000
Independent Director	-	Director	46,000	Commissioner	219,000
Independent Director	-	Director	86,000	Commissioner	85,000
Independent Director	-			Associate	242,000
				Associate	87,000

GAS INDUSTRY CO		ELECTRICITY AUTHORITY		COMMERCE COMMISSION	
Salary range	No. of Employees	Salary range	No. of Employees	Salary range	No. of Employees
\$150,000 - \$160,000	1	\$150,000 - \$160,000	3	\$150,000 - \$160,000	4
\$160,000 - \$170,000	-	\$160,000 - \$170,000	3	\$160,000 - \$170,000	1
\$170,000 - \$180,000	-	\$170,000 - \$180,000	3	\$170,000 - \$180,000	3
\$180,000 - \$190,000	-	\$180,000 - \$190,000	3	\$180,000 - \$190,000	1
\$190,000 - \$200,000	1	\$190,000 - \$200,000	2	\$190,000 - \$200,000	1
\$200,000 - \$210,000	-	\$200,000 - \$210,000	1	\$200,000 - \$210,000	1
\$210,000 - \$220,000	-	\$210,000 - \$220,000	-	\$210,000 - \$220,000	1
\$220,000 - \$230,000	-	\$220,000 - \$230,000	1	\$220,000 - \$230,000	1
\$230,000 - \$240,000	-	\$230,000 - \$240,000	1	\$230,000 - \$240,000	-
\$240,000 - \$250,000	1	\$240,000 - \$250,000	1	\$240,000 - \$250,000	-
\$270,000 - \$280,000	-	\$270,000 - \$280,000	-	\$270,000 - \$280,000	1
\$300,000 - \$310,000	-	\$300,000 - \$310,000	1	\$300,000 - \$310,000	-
\$320,000 - \$330,000	-	\$320,000 - \$330,000	-	\$320,000 - \$330,000	1
\$330,000 - \$340,000	-	\$330,000 - \$340,000	1	\$330,000 - \$340,000	-
\$430,000 - \$440,000	1	\$430,000 - \$440,000	-	\$430,000 - \$440,000	-

- 11.6 There may however, be issues around opportunities for personal development, growth and organisation renewal in small agencies.

Q36. Where are the gaps in regulator workforce capability? Can you provide examples?

- 11.7 No particular examples.

Q37. What is the potential to improve capability through combining regulators with similar functions compared with other alternative approaches?

- 11.8 We think there is an opportunity here, particularly for agencies primarily involved in market administration and compliance activities.

Q38. When do changes to institutional arrangements work best to improve capability and when are other solutions preferable?

- 11.9 A change to institutional arrangements is necessary when the capability shortfall is likely to be of an enduring nature.

12. Compliance monitoring and enforcement

Q39. Can you provide examples of strengths and challenges in the way regulators monitor and enforce regulations? What are the consequences?

- 12.1 Both the Electricity Authority and the Gas Industry Co have developed separate bespoke compliance regimes to ensure that the industry complies with market regulations.
- 12.2 In addition, both industry regulators assist industry participants to achieve compliance by providing advice and information over the phone and in face to face meetings.
- 12.3 In both sectors there appears to be continuous improvement in compliance levels. For example, the Gas Industry Co 2012 Annual Report notes it has experienced a 10% decrease in alleged breaches, which it attributes to growing familiarity with the rules and some rule changes.
- 12.4 The Gas Industry Co regime was developed with the assistance of a consultant who had served on the electricity Rulings Panel, and it benefited from knowledge of that regime. The regime is structured around a market administration role (undertaken in-house), an investigatory function (out-sourced) and a single person Rulings Panel appointed by the Minister of Energy.

Q40. Do you New Zealand regulators have access to a sufficient range of enforcement tools? If not, what evidence is there to suggest a broader range of tools would promote better regulatory outcomes?

- 12.5 We are not aware of any lack of enforcement tools in the utilities sector.

Q41. What sort of regulatory regimes are suited to more (or less) discretionary enforcement?

- 12.6 If the regime involves mandatory reporting by service providers and industry participants that results in a large number of potential breaches, it is sensible to have a screening threshold so that the cost of enforcement does not exceed the market impact of the breach.
- 12.7 For example, the Gas Industry Co's Annual Report notes that in 2012 and 2013 approximately 80% of rule breaches were not material and therefore not referred to the investigator.

Q42. Can you provide examples of where a regulator has too much or too little discretion in enforcing regulations? What are the consequences?

- 12.8 We think the electricity and gas compliance regimes encourage appropriate settlement agreements between the parties.

Q43. Can you provide examples of where risk-based approaches have been used well? What are the critical pre-conditions for effective implementation of risk-based approaches to compliance monitoring and enforcement in New Zealand?

12.9 No particular comments or examples.

Q44. What are the challenges of adopting risk based approaches in New Zealand?

12.10 No particular comments or examples.

13. Engagement

Q45. Can you provide examples where regulatory regimes require too much or too little consultation or engagement? What are the consequences?

- 13.1 The “self-regulatory” origins of energy regulation mean there is a strong sector history for participation in the rule-making process via working groups, public workshops, formal consultation papers and hearings.
- 13.2 This is appropriate, as an effective consultation process will improve the quality of the decisions being made by regulatory agencies. This ensures they have regard to relevant matters and base decisions on correct information, and give affected people an opportunity to be heard and have their points of view properly considered.
- 13.3 However, improvements are also possible and there are three matters which we would single out for consideration in any future guidelines on regulatory practice:
- (a) consultation needs to be proportionate to the value at risk. An example of too much consultation is the Gas Industry Co’s annual levy process;
 - (b) meaningful consultation can only occur through a measured and staged approach. An example of an unfortunate “omnibus” consultation is the Electricity Authority’s October 2012 paper on transmission pricing; and
 - (c) there needs to be a separate engagement process for review of legal drafting after policy issues have been determined.

Too much consultation

- 13.4 Consultation is not costless and there can be too much of it. An example of a regulatory regime which requires too much consultation is the process by which Gas Industry Co receives an annual levy (outlined in Figure 3).
- 13.5 As noted in response to previous questions, the Gas Industry Co has a narrow statutory function and the Minister has a right of statutory veto on its policy recommendations. Its other market administration roles are mandated by regulations (for examples, see Case Study 7. It may only use its annual levy for these roles. It must declare its intentions in advance in a Statement of Intent and report its progress in a published annual report. It may not undertake an activity not permitted by its constitution. Adding the further step of an annual consultation process with stakeholders for a levy which is only \$4.6m per annum appears to be unnecessary. It would seem more efficient if the board (which includes levy payers) directly advised the Minister on this matter.

Consultation which is too hasty

- 13.6 The policy making process contains a number of distinct phases, and care needs to be taken not to rush the consultation process by producing an omnibus paper which moves rapidly from “problem definition” to “applicable solutions”, “costs benefit analysis of solutions”, “implementation process”, and “legal drafting”.
- 13.7 An example of an omnibus paper is the Electricity Authority’s Consultation Paper on Transmission Pricing. It is very difficult for affected stakeholders to respond to a paper of this kind and there is a real risk that the objectives of such consultation will not be achieved.

13.8 For completeness, it should be noted that the Authority is now following a different approach.

Getting the drafting right

13.9 We have observed that the opportunity to comment on the drafting of new regulations is often included in a lengthy consultation paper addressing policy issues.

13.10 The result is that the proposed drafting gets minimal scrutiny by submitters whose primary focus is understandably on the policy issues.

13.11 This is a lost opportunity. We would therefore recommend a separate process for consultation on legal drafting matters to avoid the risks of subsequent court scrutiny such as:

- (a) the “infelicitous” drafting noted by Justice Hansen in *Jade Software (NZ) Limited v Auckland Gas Company Ltd.*, Gas Rulings Panel, 28 May 2010 at p 6; and
- (b) the “*particularly problematic*” drafting of sub-clause (c)(v) in the definition of undesirable trading situation by the High Court in *Bay of Plenty Energy v The Electricity Authority* [2012] NZHC 238 at para 139.

Q46. What are the characteristics that make some regulations more suited to prescriptive consultation requirements than others?

13.12 This issue does not arise in the utilities sector where the statutory framework mandates consultation.

Q47. What forms of engagement are appropriate for different types of regulatory regime? When do formal advisory boards work or not work well?

13.13 We think evidence-based public consultation processes are appropriate for the utilities sector.

13.14 We note the electricity sector has also established a Security and Reliability Council to provide independent advice to the Authority on the performance of the electricity system and the system operator and reliability of supply issues.

13.15 This role has the potential to overlap with the functions of the Electricity Authority supervising the delivery of the system operator service provider contract and the board of Transpower. It may benefit from an external review five years after establishment.

Q48. How best can the challenges of working in partnership be met by regulatory agencies? What models, methods and approaches are most successful?

13.16 Working groups can be useful forums to test and develop:

- (a) an evidence based problem definition;
- (b) a short list of practicable options that address the identified problem;
- (c) an evaluation of these options in accordance with the statutory objective;

(d) a costs and benefits assessment of selected options; and

(e) an appropriate transition and implementation programme.

13.17 This process works best if there are clear rules of engagement and transparency around the working group deliberations.

13.18 The working group process should not be a substitute for a formal consultation process conducted by the decision-maker. This includes the opportunity for affected stakeholders to present their perspectives at a hearing or conference.

14. Organisational culture

Q49. What elements of a regulatory regime's design have the biggest influence on culture? Why?

- 14.1 We agree that leadership has a significant influence on the culture of an organisation. A good leader of a regulatory agency will encourage a productive and collaborative multi-disciplinary team environment within the organisation, and effective two way communication with external stakeholders. This is a key building block to ensure regulation is informed by the best available evidence.

Q50. How well do regulatory agencies ensure consistency of approach between or amongst regulatory staff, so that individual variations are minimised?

- 14.2 Active consultation and very transparent processes in the energy sector mean that there is very little (sustainable) opportunity for inconsistent approaches.

Q51. Can you provide examples where the culture or attitude of the regulator has contributed to good or poor regulatory outcomes? How?

- 14.3 No specific examples.

Q52. Can you provide examples where the culture within a regulator supports or inhibits staff in making difficult decisions, particularly where those decisions may be unwelcome to government, regulated parties or the general public? How?

- 14.4 No specific examples.

Q53. Can you provide examples where a regulator provides too much value on managing risks to itself, relative to other priorities such as the regulatory objective, or customer service? What are the consequences?

- 14.5 No specific examples.

Q54. Can you provide examples of regulators whose approach to their business is largely shaped by their reliance on a particular profession? How might that approach be different if it drew on a wider range of professions?

- 14.6 The regulation of utilities requires a mix of professional disciplines: economic, technical, commercial, financial and legal. Regulators will achieve the best outcomes if all disciplines are involved in the analysis of new policy proposals.

- 14.7 A number of industry participants have commented to us that there is an over-reliance on economists at the Electricity Authority. These comments were particularly prevalent when the Electricity Authority held a budget style lock up with economic advisers prior to the release of a Consultation Paper on transmission pricing methodology.

15. Accountability and transparency

Q55. Can you provide examples of how accountability or transparency arrangements improve or undermine the effectiveness of a regulatory regime?

- 15.1 Accountability frameworks are important requirements for organisations funded by statutory levies.
- 15.2 The reporting framework for smaller regulatory regimes can have costs disproportionate to the transparency benefits.
- 15.3 Case Study 7 sets out our understanding of the accountability regime which applies to the Gas Industry Co. Whilst this creates a high level of transparency about its operations, it seems a little excessive for the nature of its functions.

Case Study 7: Accountability framework for co-regulatory body under the Gas Act

Accountability to shareholder

- *The industry body is a limited liability company incorporated under the Companies Act. It has a board of directors appointed by its industry shareholders which include both industry affiliated members and members with no material interests in the gas sector. The chair must be a non-affiliated entity.*
- *The constitution (which has to be approved by the Minister of Energy) sets out the role of the Company. It provides:*

“The principal purpose of the Company is to perform the functions and duties, and exercise the powers, of the industry body under Part 4A of the Gas Act, ...

- (a) to recommend gas governance regulations and gas governance rules under Part 4A of the Gas Act;*
- (b) to administer, monitor compliance with, investigate, enforce, and apply penalties or other remedies for contraventions of, any or all of the gas governance regulations and gas governance rules;*
- (c) to establish, operate, and facilitate the operation of, markets for industry participants; and*
- (d) to establish or implement one or more complaints resolution systems required by gas governance regulations or gas governance rules;*
- (e) to recommend regulations under section 43ZZB of the Gas Act that require industry participants to pay a levy to the Company, and collect any such levy; and*
- (f) to advise and report to the Minister in relation to the New Zealand gas industry.*

...

“In addition ... the Company may undertake any one or more of the following:

- (a) any role that the Government requests it to, or indicates that it should undertake in a statement of government policy under section 43ZO of the Gas Act;*
- (b) any role in relation to the recommendation, establishment and operation of arrangements made for any purpose for which gas governance regulations or rules may be made; and*
- (c) any role in relation to existing arrangements (or any replacement thereof) for:*
 - (i) upstream or downstream reconciliation of gas quantities;*

Cont'd

(Case Study 7 continued)

- (ii) *gas outages or security of supply contingencies; and*
- (iii) *open access to distribution gas pipelines or transmission gas pipelines downstream of gas processing facilities.”*

- *The Board has the usual company law obligations in relation to financial solvency and compliance with the constitution. In order to ensure these obligations are met the Board meets regularly and receives the usual board reports. The Board also oversees the production of a set of accounts which meet the requirements of the Companies Act and the Financial Reporting Act. The Company also holds an Annual General meeting of its shareholders.*

Accountability to other stakeholders

- *In addition to these accountability requirements, Gas Industry Co needs to develop and consult on its work programme each year as part of its annual application for levy regulations.*
- *It must also develop and consult with the Minister on its Strategic Plan which covers:*
 - (a) *the key background information about the industry body and his operating environment;*
 - (b) *the nature and scope of the industry body's intended operations;*
 - (c) *the specific outcomes or objectives that the industry body seeks to achieve or contribute and how those objectives and outcomes might relate to any objective and outcomes referred to in this subpart or in any GPS objectives and outcomes;*
 - (d) *how the industry body intends to conduct its operations to achieve those impacts and outcomes or objectives;*
 - (e) *the main financial and non-financial measures and standards by which the future performance of the industry body may be judged; and*
 - (f) *the matters on which the industry body will consult or notify the Minister before making a decision, the matters on which it will report to the Minister, and the frequency of reporting other matters the industry body is required to include in the industry body statement of intent under this Act or another Act and any other matters that are reasonably necessary to achieve an understanding of the industry body's intentions and direction.*
- *It must produce and have tabled in the house an Annual Report which must include:*
 - (a) *information necessary to make an informed assessment of the industry body's operations and performance under this Part for that year including an assessment against its statement of intent prepared under this subject and the beginning of the year and against the GPS objects and outcomes;*
 - (b) *a report on the exercise of its powers conferred by this Part during the year;*
 - (c) *audited consolidated financial statements for the industry body prepared in accordance with the Financial Reporting Act;*
 - (d) *a report on those financial statements that is signed by an auditor;*
 - (e) *a report of the matters required to be included in the annual report of a company by paragraphs (e), (f) and (g) of section 211(1) of the Companies Act;*
 - (f) *the disclosure required under section 43ZX ; and*
 - (g) *any matters that relate to or affect the body's operations that the body is otherwise required or has undertaken or wishes to report on in its annual report.*

Accountability to the Minister

- *In addition the Gas GPS also requires it to meet quarterly with the Minister of Energy to report on its progress in delivering the outcomes in the GPS.*

Q56. What types of accountability arrangements are appropriate for different types of regulatory regimes?

- 15.4 Regulated entities with less than 20 staff need to have a streamlined reporting arrangement.

16. Performance assessment

Q57. Are the problems that the Commission identified in the assessment of local government regulatory performance also evident in the assessment of central government regulatory performance? If not, how do the problems differ for central government?

16.1 Yes.

Q58. Can you provide examples where performance assessment of regulatory regimes is working well, needs improvement?

16.2 We think the Electricity Authority's assessment of stakeholder perceptions of competition, reliability and efficiency across the electricity market is a useful adjunct to its other measures. However, we note it can be very difficult to separate industry performance from the performance of the regulator.

Q59. When are feedback loops being used well to improve the performance of New Zealand regulatory regimes? When aren't they?

16.3 No particular comments.

Q60. Can you give examples of indicators or proxies that are effective as early warning signs of regulatory non-compliance or failure?

16.4 No particular comments.

Q61. Can you provide examples of regulatory regimes with effective processes for formally or informally raising concerns about potential regulatory failures? What examples are there of regimes that handle this poorly? What are the consequences?

16.5 Both the Electricity Authority and the Gas Industry Co have established processes for regulated parties to "log" concerns about the efficacy of particular regulations. These are considered when annual work programmes are developed.

17. Concluding remarks

- 17.1 New Zealand's current utility regulation is the outcome of particular circumstances and experiences in its history, and there may be scope for review of some elements of the various regulatory regimes.
- 17.2 New Zealand has a small population base to carry the costs of regulation and therefore needs to "think smarter" about its regulatory institutions and practices. This submission has sought to provide case-studies and evidence based answers to the questions in the Issues Paper, to assist the Commission with this task.

18. Authorship (and disclaimers)

- 18.1 This submission has been prepared by Christine Southey who is a co-leader of MERW's regulated industries group. It has been peer reviewed by Catherine Ross who practices in the same group.
- 18.2 The views expressed in this submission represent the views of the author. We note that MERW either acts or has acted for a number of clients affected by the Issues Paper and inquiry. This submission draws on the author's experience in acting for clients and her general knowledge of the utilities sector, but does not purport to represent the views of any of MERW's clients (current or past). Individuals within MERW may also hold different views from those expressed in this submission.