



MAJOR ELECTRICITY USERS' GROUP

6 July 2007

Mr Geoff Connor
Commerce Act review
Ministry of Economic Development
WELLINGTON
By email to commerceactreview@med.govt.nz

Dear Geoff

Submission on Review of Regulatory Control Provisions under the Commerce Act

1. This is a submission by the Major Electricity Users' Group (MEUG) on the Ministry of Economic Development discussion document *Review of Regulatory Control Provisions under the Commerce Act 1986* published 4th April 2007.
2. As part of the Consumer Coalition on Energy (CC93), MEUG has also made a submission on the review. To avoid duplication most of the points raised in the CC93 submission are not repeated in this submission. MEUG fully support the views of CC93.
3. Answers to the questions in the discussion document are contained in the appendix to this submission.
4. Relative to the status quo regulatory provisions of the Commerce Act, MEUG:
 - a) Agrees with the discussion paper proposal that there should be a specific purpose statement for Part 4. The suggested purpose statement in the discussion paper could be improved by:
 - i) Removing duplication in the purpose statement regarding efficient investment incentives; and
 - ii) Keeping alive the possibility of introducing competitive pressures on monopolies or near monopolies.
 - b) Agrees with the recommendation in the discussion paper to retain both economic efficiency and consumer protection criteria in deciding whether control is desirable. MEUG suggest the primary consideration should be economic efficiency and the secondary, that is lesser criteria, should be consumer protection or distributional effects;
 - c) Agrees with the discussion paper proposal that the Minister is required to seek advice from the Commerce Commission (the "Commission") before making a decision to control. This is an improvement on the status quo whereby the Minister can act without reference to seeking advice from the Commission;

- d) Agrees with retaining the status quo whereby companies or sectors become controlled through a Part 4 process rather than de facto being deemed to require control;
 - e) Agrees with the suggestion in the discussion paper that the "whether to control" and "how to control" phases should be undertaken simultaneously;
 - f) Agrees with the recommendation in the discussion paper to widen the regulatory tool-box available to the Commission;
 - g) Agrees with the preference in the discussion paper to collapse Part 4A into a revised generic Part 5 so that thresholds become one of a suite of available regulatory procedures;
 - h) Agrees with the suggestion in the discussion paper that generic key inputs and methodologies be posted by the Commission. MEUG suggest this approach proceed with using guidelines rather than rules because of the greater flexibility for the Commission. If problems arise with using guidelines, then the more heavy handed approach of rules could be considered. The preference of MEUG is to commence with as light-handed approach as possible because it's easier to take the next steps to rules and regulations but very difficult to unwind regulations and rules.
 - i) Has concern with the proposal for merits review. Nevertheless MEUG agrees the Ministry should continue to explore this option on the basis of a relatively limited number of opportunities in the regulatory process and as an option to enlist the use of the Australian merits review process. Part of accepting the need for more work is that MEUG recognise that the Act as a whole should be generic covering all sectors and while we believe the case for merits review in the electricity sector with respect to Part 4A has not been made, there may be a case for generic rules for other sectors of the economy. As options are firmed up a cost-benefit-analysis relative to the counterfactual of having no merits review will need to be undertaken.
5. MEUG suggest that any review of Part 4, 4A and 5 should also encompass:
- a) A review of the section 26 statement issued to the Commission regarding electricity sector lines businesses, ie that statement should become redundant following any amendment to the Act; and
 - b) A review of the regulatory institutions and Government Policy Statement affecting electricity transmission and distribution. The preference of MEUG is to either amend the governance of the Electricity Commission so that it becomes independent like the Commerce Commission or to shift decision making on electricity transmission and distribution services from the Electricity Commission to an independent regulatory entity.
6. This submission is not confidential.

Yours sincerely



Ralph Matthes
Executive Director

Appendix: Q&A for MED discussion document Review of Regulatory Control Provisions under the Commerce Act 1986

<p>Chapter 1: Introduction</p> <p>Q1. Do you have any comments on the desirable characteristics of a regulatory regime as outlined in this Chapter?</p>	<p>MEUG agree with the desirable characteristics listed in paragraph 23 of the discussion paper apart from the last bullet point where the word “appropriate” leaves scope for a wide range of interpretation. MEUG suggest the last bullet point could be restated,</p> <p>“For each regulatory layer or function there is a clear scope of duty, accountability and independence from political influence. Where political decisions are made then those are transparent.”</p>
<p>Chapter 3: Potential issues with the current regime</p> <p>Q1. Does the above list capture the main issues with the current regulatory regime?</p>	<p>Yes, although:</p> <ul style="list-style-type: none"> ▪ MEUG does not necessarily agree the issues are sufficient to warrant some of the changes advocated by some parties, eg in the electricity sector some have argued for merits review as a solution for a problem that, in the view of MEUG, to date there is no evidence of. ▪ There is one important one omission – refer Q3 below.
<p>Q2. Are these issues adequately identified and described?</p>	<p>Yes.</p>
<p>Q3. Are there are any other issues with the current regime that are not listed above and should be considered as part of this review?</p>	<p>In the electricity sector end consumers have not had resources to provide an effective countervailing argument. The CC93 submission comments on this “information and resource asymmetry problem.”</p>
<p>Chapter 4: Objectives of economic regulation</p> <p>Q1. Do you agree that a regulatory regime needs to be available to address issues in markets with monopoly characteristics?</p>	<p>Yes.</p>
<p>Q2. Do you consider that the sole or primary objective of a regulatory regime should be economic efficiency or consumer protection (distribution), or do you consider that both should be taken into account?</p>	<p>In markets without monopoly characteristics the only objective of a regulatory regime should be to promote competition (economic efficiency).</p> <p>In markets with monopoly characteristics the primary objective of a regulatory regime should be to facilitate means to introduce, or at least mimic, competitive pressures (economic efficiency) balanced against a lesser secondary objective to improve benefits to acquirers (excess rent redistribution net of regulatory costs, where excess rent is sum of inefficiencies and excess profits).</p>

<p>Chapter 5: Purpose statement</p> <p>Q1. In your opinion, is a regulatory-specific purpose statement desirable?</p>	<p>Yes.</p>
<p>Q2. If so, do you agree with the proposed regulatory-specific purpose statement, or do you prefer an alternative formulation? If so, please suggest specific wording.</p>	<p>MEUG agree with the proposed purpose statement in paragraph 87 subject to 2 qualifications:</p> <p>First, MEUG believe paragraph (d) is redundant as follows:</p> <ul style="list-style-type: none"> ▪ Paragraph (d) of the proposed purpose statement requires the regulatory control regime to facilitate investment. Paragraph (b) of the proposed purpose statement already provides for the regulatory regime to have incentives for lines businesses to “improve efficiency and provide services.” To improve efficiency and provide services must include capital investment. Therefore paragraph (d) is redundant because ensuring lines businesses have incentives to invest is already covered in paragraph (b). ▪ Notwithstanding the bullet point above, perhaps to make the point absolutely clear, then paragraph (b) could be restated by including the new text in the brackets as follows: <p style="margin-left: 40px;">“Have incentives to improve efficiency (primarily by capital investment) and provide services at a quality that reflects consumer demands.”</p> ▪ Note MEUG is unsure of what the reference to “related businesses” means in paragraph (d). <p>Second, MEUG suggest there are few activities that could not be subject to some competitive pressures. For example in the electricity sector:</p> <ul style="list-style-type: none"> ▪ There are examples of competing embedded networks; ▪ Line services can and are tendered out to drive costs down for equivalent service levels; ▪ In other jurisdictions there are competing high voltage transmission service providers – MEUG see no reason why that scenario should not develop in New Zealand, or at least the threat of new entry to keep the incumbent honest; ▪ Even an almost perfect natural monopoly such as the System Operator can be made contestable by splitting from the Transmission Asset Owner business and tendering that service provider function. <p>As a result MEUG suggest any Part 4 purpose statement should keep alive the possibility of introducing competition for a controlled sector or company.</p> <p>Additional text to the purpose statement could be added as follows:</p> <p style="margin-left: 40px;">“And the regulations should consider and facilitate opportunities to introduce or mimic competitive pressures on the controlled entities.”</p>

<p>Chapter 6: The decision on whether to impose regulation</p> <p>Q1. Do you agree with the proposed criteria for deciding on whether regulation may be imposed?</p>	<p>Refer answers to Q2 and Q3 below.</p>
<p>Q2. If you agree that one of the tests for whether control may be imposed should be where the long term benefits to acquirers exceed direct and indirect costs, do you consider that such benefits should (a) "substantially" or (b) "clearly" exceed costs, or should there be some other guidance on weighting?</p>	<p>If "clearly" is a higher hurdle than "substantially", then MEUG supports "clearly." Alternatively if "substantially" is a higher hurdle than "clearly", then MEUG supports "substantially."</p> <p>Any review of the Act should not, relative to the status quo, increase the possible number of sectors or businesses in the economy that could potentially be controlled.</p>
<p>Q3. If you agree that one of the tests for whether control may be imposed should be where the long term benefits to acquirers exceed direct and indirect costs, should those benefits be considered regardless of whether acquirers acquire the goods and services directly or indirectly, or should it be necessary to establish that benefits will be passed on to end users (or consumers or end-acquirers)?</p>	<p>As part of an inquiry into whether a sector should be subject to economic regulation or a specific company controlled there will inevitably be an examination of the industry supply chain as a whole. Hence the Commission will gain some insights into whether or not the assumption that estimated benefits of regulatory control will flow through to acquirers (ie end consumers). The value of those insights is to assist the Commission consider whether to commence a separate investigation under Part 2 of the Commerce Act. For any Part 4 investigation the Commission should assume, unless proven otherwise (eg through a Part 2 inquiry), that any assumed benefits of control will flow through to acquirers.</p>
<p>Q4. Should the current provisions in the Act allowing control to be imposed in the interests of suppliers (to a monopsonist) be retained?</p>	<p>Yes.</p>
<p>Q5. Do you agree that there should not be a legislative test for when regulation should be imposed?</p>	<p>Yes. Using a test for when regulation should be imposed would be a backward step.</p>
<p>Q6. Do you agree that the Minister should remain the decision-maker on whether control should be imposed under Part 4, but that that the Minister must receive a report and recommendation from the Commerce Commission before making a decision?</p>	<p>Yes.</p>
<p>Q7 Do you agree that the decisions on whether and, if so, how to regulate should be undertaken simultaneously rather than sequentially?</p>	<p>To undertake a cost-benefit-analysis to decide whether to control, the counterfactual is likely to be the case "not to control" and the factual(s) alternative ways to control. If the latter are well specified then the results of the cost-benefit-analysis will be more robust than otherwise. Therefore a simultaneous decision making process is probably better.</p>

<p>Chapter 7: Types of economic regulation</p> <p>Q1. Do you agree that it is desirable to widen the scope of the Commerce Act by providing for regulatory options other than control, specifically:</p> <ul style="list-style-type: none"> ▪ negotiation/arbitration and ▪ price monitoring/information disclosure? 	<p>Definitely.</p>
<p>Q2. Do you consider that specific, easier tests should be provided to determine whether lighter-handed types of regulation, such as information disclosure, may be imposed, such as:</p> <ul style="list-style-type: none"> ▪ meeting the competition criteria only ▪ requiring qualitative (rather than quantitative) cost-benefit analysis? 	<p>Definitely.</p>
<p>Chapter 8: Key input decisions</p>	
<p>Q1. Do you see value in having key input decisions set as a stand-alone process in advance of an inquiry and recommendation to regulate? If so, should they be set for a specific sector once an inquiry has been initiated, or set generically irrespective of whether or not an inquiry has been initiated?</p>	<p>Likely to be value in establishing key input decisions because of economies of scale and increased certainty to all parties. It might be a case of a the Commission posting and occasionally updating generic approaches for some key inputs (eg WACC and asset valuation methodologies) irrespective of whether inquiries have been initiated, with more industry specific assumptions being considered if and when industry or company specific inquiries commence.</p>
<p>Q2. Is it practical, or possible, to set generic methodologies that could apply to all potentially regulated sectors?</p>	<p>See answer to Q1 above</p>
<p>Q3. Do you consider that input methodologies should be set:</p> <ul style="list-style-type: none"> ▪ as guidelines by the Commerce Commission; ▪ as Rules by the Minister following a recommendation from the Commission; or ▪ another option (please specify)? 	<p>Preference is as guidelines rather than Rules in order to avoid increasing regulatory costs and to provide greater flexibility (easier to amend Guidelines). If problems emerge using Guidelines then increasing the regulatory intervention using rules could be considered. Jumping straight to the use of Rules when guidelines would have been sufficient will be much more difficult to reverse.</p>

Chapter 9: Regulatory control design issues	
Q1. Should specific provision be made (e.g. in Part 5) to allow the Commerce Commission to use comparative benchmarking as a methodology for setting control terms?	Part 5 should not prevent comparative benchmarking being one of many options the Commerce Commission may use.
Q2. Should specific provision be made to allow the Minister to request at the Commission to consider whether economic regulation may be imposed on a sector as a whole (rather than each individual firm within a sector) and if so, should provision be made for cost benefit analysis on this matter to be undertaken in qualitative (rather than quantitative) terms?	The option of using light-handed economic regulatory tools such as information disclosure for a sector as a whole should be available. The most extreme option of economic regulation, that is control, should only be available on a company specific basis. MEUG does not support the proposal that a cost-benefit-analysis on qualitative terms only would be sufficient.
Q3. Is there value in allowing firms to propose their own control terms for the Commission's consideration ("propose/respond" model)?	Yes.
Q4. If firms are able to propose their own control terms, should the Commission be required to accept proposals that meet pre-set criteria? Do you have any comment on the proposed "reasonableness criteria"?	Yes. At this stage no comments on reasonableness criteria although if this proposal is developed further MEUG will be very interested in the criteria.
Q5. If firms have the ability to propose their own control terms, should this proposal take place before or after declaration of control by the Minister (note that in section 9.3 the paper proposes different sequences for control of individual firms compared to sector control)?	No comment at this stage.
Chapter 10: Possible packages of "how to regulate"	
Q1. With regard to the Part 4A thresholds regime do you favour: <ul style="list-style-type: none"> ▪ retaining the threshold regime and making it more generic (that is, applicable to sectors other than electricity lines businesses), or ▪ repealing Part 4A and amending Part 5 to allow the Commerce Commission to use comparative benchmarking to set terms and conditions for control while allowing firms to seek customised control terms. 	Preference is to repeal Part 4A from end of next threshold period, ie 31 March 2014.
Q2. In your opinion, are there other options for addressing the issues with the Part 4A thresholds regime?	No comment.
Q3. Are small businesses within a sector likely to be disproportionately affected by the requirements of the regulatory regimes proposed in this document? What are the likely incremental costs of complying with the current Part 4A and proposed alternative regimes? How could these costs be minimised?	MEUG will be interested in viewing the replies from small lines businesses before making comments on this issue.
Q4. Should local community owned trusts be subject to a different regulatory regime than larger non-trust electricity lines businesses?	No.

Chapter 11: Processes for amending and enforcing control terms	
Q1. Do you agree that control terms should not be re-opened within a specified control period, other than under exceptional circumstances? If so, do you agree with the exceptional circumstances suggested in this Chapter?	Yes.
Q2. Are the current provisions relating to penalties in the Act for breaches of control terms (s70C) satisfactory or should additional guidance be provided?	Don't know.
Chapter 12: Accountability mechanisms	
Q1. Do you consider that it is desirable to provide for merits review of regulatory decisions or does judicial review provide sufficient "checks and balances" on regulatory decisions?	Based on the experience of the Commission performance with Part 4A to date, there is no need for a merits review process. However MEUG is supportive of a more generic approach to Part 4 and 5 and therefore as a principle a limited scope merits review might be worth considering.
Q2. Do you agree with the document's conclusions that, if merits review is provided for, it should only apply to control decisions made by the Commission and be limited to the form of "appeals by way of re-hearing" where new evidence can be introduced only if it could not have been submitted at the original decision-making stage?	See answer to Q1 above.
Q3. What is your preferred composition of any merits review body, taking into account New Zealand's small size and limited resources?	Perhaps similar to the Australian approach, including even using the Australian merit review entities. The option of convening a specialist merits review as needed compared to having a standing tribunal should be considered.
Chapter 13: Next steps	
Q1. Submitters are requested to provide specific, quantified information on costs and benefits wherever possible to assist the Ministry in undertaking any cost-benefit analysis.	No comment.