

MIGHTY RIVER POWER

**SUBMISSION TO THE MINISTRY OF
ECONOMIC DEVELOPMENT ON**

**REVIEW OF REGULATORY CONTROL
PROVISIONS UNDER THE COMMERCE ACT
1986**

6 JULY 2007

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2 EXECUTIVE SUMMARY

1. Mighty River Power congratulates the Ministry of Economic Development (MED) on the Discussion Document *“Review of the Regulatory Control Provisions under the Commerce Act 1986”*.
2. The Discussion Document is of a high quality. The discussion and argument on the different policy options for amendment of the regulatory control provisions in the Commerce Act is well-balanced and the policy options advocated largely merit consideration/introduction.
3. Economic regulation, such as information disclosure and price control, is an appropriate means of dealing with monopolies in markets where competition is not possible. If competition is possible – but not present due to, say, barriers to entry – the appropriate regulatory response is to promote further competition by removal of barriers to entry. Economic regulation in these situations would only serve to exacerbate the lack of competition. It might deal with the symptoms of the market failure (e.g. excess prices) but it would not deal with the cause of the market failure (barriers to entry).

2.1 Purpose statement

4. Mighty River Power agrees with the Discussion Document that Parts 4 and 5 of the Commerce Act should have a purpose statement, and the purposes in ss 1A and 3A are not entirely appropriate. Mighty River Power also agrees with the Discussion Document that the existing Part 4A purpose should be generalised to apply to Parts 4, 4A and 5. The Discussion Document’s proposed purpose statement largely keeps the existing Part 4A purpose in s 57E intact which we support. Section 57E of the Commerce Act is fundamentally sound, as it is focussed on the long-term benefit of consumers, and on replicating the outcomes of a workably competitive market.
5. We anticipate strenuous debate on whether the purpose should take into account wealth transfers (distributional matters) between suppliers and consumers, as well as efficiency changes, as s 57E presently does. In a workably competitive market, suppliers are only able to earn ‘monopoly profits’ (profits above WACC) where they operate more efficiently than their competitors. Firms in workably competitive markets have to improve efficiency by more than their competitors in order to earn economic rents. Firms in a workably competitive market do not get the opportunity to simply hold on to economic rents, as if it was some kind of right. The operation of price control should be no different.
6. The most significant change to s 57E is the addition of criterion (d) relating to investment incentives. We support this change, which we consider is implicit in the words *“long term benefit of consumers”*. There are some changes that could be made to improve the proposal

(for example, using the term *“competition is limited”* which is already in use, rather than *“there is little or no competition”*), but these amount to fine-tuning.

2.2 Criteria for economic regulation

7. A well specified purpose statement can be used as a substitute for specific tests or criterion for regulation. Accordingly, as well as adopting a generalised purpose statement for Parts 4, 4A, and 5 of the Commerce Act, a section should be added based on s 19 of the Telecommunications Act 2001. We propose a section along the following lines:

If the Commission or the Minister (as the case may be) is required under Parts 4, 4a or 5 to make a recommendation, or a decision, the Commission or the Minister must—

- (a) consider the purpose set out in section [x]; and
- (b) make the recommendation, or decision that the Commission or Minister considers best gives, or is likely to best give, effect to the purpose set out in section [x].

Such a section would make specific tests or criterion redundant. On the assumption that this proposal is rejected, Mighty River Power has a number of comments on the Discussion Document’s draft criterion:

- a. The draft criterion does not fully align with the purpose statement. For example, the criterion refer to *“long term benefits to persons acquiring the goods or services”* whereas the purpose statement refers to the *“long term benefit of consumers in New Zealand”*. This could mean that the criterion is satisfied and regulated control introduced, even though regulated control may conflict with the purpose statement. Price control may be in the interests of acquirers but not consumers in New Zealand.
- b. Mighty River Power supports the introduction of the concept *“there is little prospect for competition to develop”* as part of the test for whether price control should be introduced. If competition is limited in the market due to barriers to competition it would be more appropriate for the Government to remove those barriers than to introduce price control. Price control should only be introduced where competition is limited AND there is little prospect of competition developing.
- c. There are markets, notably in telecommunications, where competition is limited but there are some small competitors that compete against an incumbent operator with substantial market power. The competition criterion should recognise this by requiring that competition is limited, there is little prospect of competition developing AND the goods or services are supplied by a firm with substantial market power. Proposed criterion A and B should both be applied.

2.3 Decision-making process

9. Mighty River Power agrees the Minister should make the decision on whether to invoke price control (unless the Minister has placed the industry under a generic Part 4A regime), but only

after receiving a recommendation from the Commerce Commission to invoke price control. This change will reduce regulatory uncertainty, and the risk regulatory decisions will become more politicised.

10. Mighty River Power also agrees the Commerce Commission (and Minister) should make decisions on whether to invoke price control and how to price control at the same time, rather than sequentially as is presently the case. The matter of whether price control should be introduced, and what the benefits of price control are, depend on how it would be operated.

2.4 Widening of the economic regulation tools

11. Mighty River Power is comfortable with the “*economic regulation*” tools in the Commerce Act being widened. We have no issue with information disclosure, a generic Part 4A and a negotiate/arbitrate regime per se. The concern we have is that widening the range of economic regulation tools would complicate decision making processes. It would also increase regulatory uncertainty. Firms could have less certainty as to the type of regulation that may be imposed and decisions using different regulatory tools would provide less precedent value for other decisions. Additional tools should only be introduced if there are considered to be clear benefits.
12. The addition of these tools would necessitate that the Commission consider which option would best give effect, or likely best give effect, to the (new) purpose of Part 4, when undertaking an investigation under Part 4 of the Commerce Act. Consequently, the same tests should be required for each of these options. They should not have a lesser test than price control.

2.5 Key input decisions

13. The Discussion Document proposes that key input decisions into price control/economic regulation be made prior to any price control/economic regulation investigation. Mighty River Power sees benefit in this.
14. However, the Commerce Commission already has the scope to make key input decisions prior to an investigation. The Commerce Commission has produced numerous Guidelines on aspects of its roles. The Commission is also in the process of undertaking a generic review of how it calculates WACC, which is obviously a key input into any decision on economic regulation.
15. We see value in having key input decisions, particularly on generic inputs such as WACC, made as a stand-alone process in advance of any inquiry and recommendation to regulate. However, but we consider that it would be best to leave the decision on whether to prescribe key inputs in advance to the Commerce Commission. The Commerce Commission is best

placed to make judgements as to whether Guidelines should be introduced on key inputs, based on a balancing of its various priorities and limited budget and resources.

2.6 Undertakings

16. The Discussion Document suggests that this could be changed such that the Commission could be required to accept proposals from the regulated party that meet specific criteria.
17. Mighty River Power is comfortable with the Commerce Commission having the discretion to accept Undertakings from regulated parties, so long as the process is transparent and includes full consultation. Such arrangements could mirror the Undertakings provisions that were introduced in the Telecommunications Act 2001 last year. They would also presumably mirror what appears to be the Commission's present approach to Administrative Settlement Agreements. We believe any such arrangements should be subject to strict time-limits, as we are concerned by the substantial amount of time the present Agreements are taking to be reached.
18. Obviously the merit of a requirement that the Commerce Commission automatically be required to accept proposals that meet specified criteria would depend on the detail of the specified criteria. Based on the proposed 'reasonableness criteria' in the Discussion Document we doubt this option would be a good idea.
 - a. The proposed criteria provides no surety that a firm's proposed control terms would better satisfy the long-term benefit of consumers than price control.
 - b. The proposed criteria could distort firms' incentives. For example, the criterion could only be satisfied (in particular, principle 2) if significant capital expenditure is required. This could incent firms to under-invest (thereby effectively providing them with a 'get out of jail' card), which would be contrary to the Government's emphasis on the importance of infrastructure investment.
 - c. The proposed criteria would require the firm to demonstrate that necessarily capital expenditure cannot be financed within the proposed price/revenue path, and that the proposed quality terms are too stringent. If the firm is able to do this, the Commerce Commission would presumably amend its proposed regulatory terms to address the matters anyway.

2.7 Merit-based appeals

19. Mighty River Power agrees with MED that the Commerce Commission should be subject to merits review and the scope of merits review should be limited to appeal by way of rehearing (where new evidence can only be presented if it is fresh material and could not have been presented at the stage of the original decision-making). We also agree that the grounds of review should be limited to material issues of contention.

20. The review process should tackle the broader issue of whether regulatory bodies should be subject to merits review. In particular, we agree with the Cabinet Policy Committee¹ that now is an appropriate time “to consider whether merits review should be introduced for EC decisions”.
21. Mighty River Power considers that Electricity Commission decisions should be subject to merits review on the same basis as proposed for the Commerce Commission – appeal by way of rehearing, limits on new evidence, review limited to material issues of contention.
22. In terms of the establishment of an entity to hear appeals from the Commerce Commission and Electricity Commission, we favour a specialist tribunal loosely modeled on the Australian Competition Tribunal - a pool of judges, economists and business people, with each case being heard by one judge, one economist, and one business person.

2.8 Areas of concern

23. In summary, Mighty River Power is largely supportive of the changes the Discussion Document is advocating. The areas we have misgivings about include:
- a. The Discussion Document considers substantive amendments to Part 4A (possible repeal) before the Part has had time to demonstrate its worth. This is not helpful in terms of ensuring regulatory certainty and stability.
 - b. Mighty River Power would not like to see the role of the Minister of Commerce in decision-making on regulatory control extended to, for example, include decisions on such matters as key input decisions for regulatory control.
 - c. Setting different criteria for different regulatory control options would be impractical, as the Commerce Commission would need to evaluate each of the options against each other.
 - d. While Mighty River Power is comfortable with options such as information disclosure, arbitrate/negotiation, and making Part 4A generic, we query how many different types of economic control are actually needed? Too many tools could complicate regulatory decision making. The Commerce Commission would not only have to decide whether price control is warranted, but also whether alternative regulatory tools would be preferable. This could heighten regulatory uncertainty.
 - e. Mighty River Power does not support firms being able to automatically avoid regulatory control if they meet pre-specified criteria. It would be extremely difficult to develop an objective set of criteria that would be appropriate.

¹ Cabinet Policy Committee paper from the Minister of Energy “Electricity Market Review: Improvements to current arrangements (Paper two)” at paragraph 148.

- f. Mighty River Power does not support providing small ELBs and/or community trust-owned ELBs with softer regulatory provisions than other ELBs. This would create perverse incentives. There are too many small ELBs. Weaker regulatory provisions would encourage small ELBs to remain small, and not integrate (in the way that trust-owned banks have consolidated).
- g. If merit-based reviews are allowed, then the regime should be carefully designed to mitigate the risks of gaming and delays in regulatory decision making.
- h. The low fixed charge tariff provisions in the Gas and Electricity Acts should be subject to the same purpose and tests as price control under the Commerce Act.

3 INTRODUCTION

24. Mighty River Power welcomes the opportunity to comment on the Ministry of Economic Development's (MED's) Discussion Document "*Review of Regulatory Control Provisions under the Commerce Act 1986*", April 2007.
25. No part of our submission is confidential. We are happy for it to be made publicly available.
26. Mighty River Power congratulates MED on the preparation of the Discussion Document. We consider that it is of a high quality; the argumentation around the different options is well-balanced and it largely advocates policy options that merit consideration/introduction.
27. In making this submission our primary focus lies with ensuring the economic regulation provisions in the Commerce Act provide a robust and effective way for dealing with instances of substantial market power, where there is no scope for addressing the market power by promoting competition/removing barriers to entry, e.g. in markets such as electricity lines and gas pipeline services that are characterised by natural monopoly.
28. The structure of this submission follows that of the Discussion Document. The questions in the Discussion Document are answered sequentially in the submission. The submission answers most but not all of the questions.

4 OBJECTIVES OF THE REVIEW

Chapter 1: Introduction

1. Do you have any comments on the desirable characteristics of a regulatory regime as outlined in this Chapter?

29. The Discussion Document lists five principles which MED considers to be desirable for the design of a regulatory regime:²

- regulatory uncertainty is minimised and stability and predictability of regulatory outcomes are improved over time;
- regulatory approaches are consistent and coherent across different firms/industries and over time;
- regulatory processes are transparent, cost-effective and timely, and also tailored to New Zealand's small scale in terms of resources and business size;
- the regulatory regime is sufficiently flexible to account for firm/industry specific circumstances, changing market conditions, innovation and experience; and
- there are appropriate levels of regulatory accountability and independence.

30. While not listed as a principle, the Discussion Document goes on to state that "*legislative change should only occur in circumstances when it is likely to result in clear benefits ...*"³.

31. Mighty River Power supports the principles contained in the Discussion Document, including the burden of proof principle. It is not clear how they have been reflected in the Discussion Document's proposals, though, as there is no subsequent explicit discussion of the principles. Mighty River Power's submission, in contrast, makes explicit references to the principles where they are relevant. We particularly draw on the principle of regulatory consistency across industries, as we consider there are a number of parallels between the Commerce and Telecommunications Acts, and the economic regulation provisions of the Commerce Act should draw on the approach taken in the Telecommunications Act.

32. The principles contained in the Discussion Document substantially overlap with the principles Mighty River Power has advocated for design of an international best practice regulatory regime:⁴

- a. *Durable market failure*: Regulatory intervention should be limited to addressing *durable market failures*; and should aim to address the market failures as directly as possible, i.e.

² Paragraph 23 of the MED Discussion Document.

³ Paragraph 24, *ibid*.

⁴ Refer, for example, to section 4 of Mighty River Power's "*Secondary Submission to the Ministry of Economic Development on Draft New Zealand Energy Strategy: Regulatory and Non-Environmental Matters*"; 5 April 2007. Principle b) parallels the principle in paragraph 24. Principle c) parallels the first bullet and part of the third bullet in paragraph 23, principle e) parallels the second bullet in paragraph 23, and principle f) parallels part of the third bullet in paragraph 23.

address the causes of the problems rather than just the symptoms.⁵ Policy development should focus on identifying what durable market failures exist that may mean the normal competitive operation of the market cannot be relied on to ensure efficient outcomes. Any policy options that the Government considers should be directly targeted at addressing these market failures. That is, the regulation should aim to directly deal with the cause of the problem (where possible) rather than the symptoms of the problem. If no market failures are identified then no further Government action is required.⁶

- b. *High standard of proof:* A *high standard of proof* should be applied to the decision whether to introduce regulation. The appropriate level of proof (how high is high?) will vary depending on the nature of the regulatory problem, and the nature of the potential regulatory solutions. Mighty River Power contends the appropriate burden of proof should be:
 - i. Higher where there is a high level of uncertainty surrounding the potential costs and benefits of intervention. Every uncertainty should count directly and clearly against intervention.
 - ii. Higher where the regulatory intervention may (negatively) impact or interfere with the natural competitive operation of the affected market(s).
 - iii. Higher where there is an asymmetry of risk between the potential benefits and costs ie where 'bad' regulation would likely have a greater negative impact than the benefit of 'good' regulation.
- c. *Regulatory stability, certainty and transparency:* There should be *regulatory stability and certainty*. Any regulatory changes should be predictable. There should be *transparency* in regulatory policy development, including rigorous consultation processes.
- d. *Clear objectives and roles:* Regulatory bodies (and decision-makers) should work within a framework of *clear objectives and roles*; with no overlaps in responsibilities. The clearer the objectives and allocation of roles are, the more likely the objectives will be achieved.
- e. *Consistency:* There should be *consistency* in regulatory approach amongst different industries (and intra-industry). Any differences should reflect industry specific characteristics.
- f. Regulation should be *cost effective*; and should only be imposed where it has been clearly demonstrated that the benefits of regulation outweigh the costs.

⁵ This is what we take from Hon Paul Swain (Minister of Communications) Speech Notes "A world leading regulatory reform" (20 December 2000) that there should be "as much market as possible, as much government as necessary".

⁶ The exception is where the Government is aiming to address social policy matters, such as protection of low income consumers.

33. The main difference between the principles advocated by Mighty River Power and those contained in the Discussion Document is that Mighty River Power explicitly advocates that regulatory intervention should be limited to addressing *durable market failures*; and should aim to address the market failures as directly as possible, i.e. address the cause of the problem rather than just the symptoms. Mighty River Power assumes MED took this principle as a given on this particular matter as the Discussion Document explicitly acknowledges:⁷

It is generally agreed that regulation should only be considered where market power is significant and sustained and cannot be more effectively addressed by other means.

34. In the context of the review of the regulatory control provisions in the Commerce Act, the relevant market failure is clearly that some firms operate in markets where competition is limited and there is little or no prospect of competition. For example, electricity lines businesses (ELBs) are natural monopolies, and have substantial market power.

35. Mighty River Power **recommends** MED expand its list of principles for design of a regulatory regime to include:

- a. Regulatory intervention should be aimed at directly addressing durable market failures, and not just the symptoms of market failure; and
- b. A high burden of proof should be applied to regulatory intervention, i.e. regulation should only be introduced in circumstances when it is likely to result in clear benefits.

⁷ Paragraph 92 of the Discussion Document.

5 POTENTIAL ISSUES WITH THE CURRENT REGULATORY REGIME

Chapter 3: Potential issues with the current regulatory regime

3. Are there any other issues with the current regime that are not listed above and should be considered as part of this review?

36. In considering potential issues with the current regulatory regime, care needs to be taken to distinguish between issues with the legislative specification of the regime, and concerns about the way in which the Commerce Commission is administering the regulatory regime.
37. Mighty River Power has, for example, expressed concern about the focus of the Commerce Commission on rates of return disaggregated by region and customer groups.⁸ We believe this is a matter most appropriately addressed through the Commission's consultation process, rather than legislative review of the Commerce Act. To that end, we note that the Commerce Commission is consulting on the revision of the thresholds for Transpower and ELBs this year.
38. One potential issue, not raised in the Discussion Document, is the treatment of revenues extracted by ELBs in excess of the Commerce Commission's price thresholds. It is not entirely clear whether this is a legislative design issue, or a matter in relation to how the Commerce Commission administers the regulatory regime. The Commission's comments on the matter suggest the former.
39. Unison extracted approximately \$27m over the five years from 2002-07 by exceeding the price thresholds. Mighty River Power submitted that an ELB which breaches the price thresholds should only be able to retain revenue earned in excess of the threshold to the extent the ELB can demonstrate that an efficient service provider would need to breach the thresholds to recover its WACC.⁹ Unison did not demonstrate this. The Commerce Commission nevertheless allowed Unison to retain the excess revenue.
40. The Commerce Commission gave as a reason for not requiring Unison to pay back the excess revenues that:¹⁰

⁸ Refer, for example, to Mighty River Power's submissions on Unison post-breach inquiry at: <http://www.comcom.govt.nz/IndustryRegulation/Electricity/ElectricityLinesBusinesses/TargetedControl/submissionsoncommissionsintentiont.aspx>.

⁹ Refer to Mighty River Power's "Submission to the Commerce Commission on Draft Decision: Reasons for not Declaring Control – Unison Networks Limited", 29 November 2006, at: <http://www.comcom.govt.nz/IndustryRegulation/Electricity/ElectricityLinesBusinesses/TargetedControl/ContentFiles/Documents/MRP%20-%20Submission%20on%20Unison%20Draft%20Decision%20Not%20to%20Declare%20Control%2029%20Nov%202006.pdf>

¹⁰ Paragraph 4.74 of the Commerce Commission's "Reasons for Not Declaring Control – Unison Networks Limited", 11 May 2007.

The Commission considers that, generally, neither control nor an administrative settlement is intended to compensate consumers by recovering any overcharging prior to a settlement being agreed (or control declared), but to ensure that the future performance of the business concerned is consistent with the Purpose Statement.

41. This effectively rewards ELBs for exceeding the thresholds. We believe that such an outcome is contrary to the purpose of s 57E of promoting the long-term benefit of end-users, and contrary also to s 57E(a)'s requirement that ELBs are limited in their ability to extract excess profits. They should only be able to increase profitability by improving efficiency.
42. Mighty River Power **notes** that care needs to be taken to distinguish between concerns with the legislative specification of the regulatory control provisions in the Commerce Act, and the administration of the regulatory control provisions by the Commerce Commission.

6 OBJECTIVES OF ECONOMIC REGULATION

Chapter 4: Objectives of economic regulation

1. Do you agree that a regulatory regime needs to be available to address issues in markets with monopoly characteristics?

43. Yes. There clearly are markets in which durable market failure exists in the form of limited competition/substantial market power. Where possible, the best way to remedy such market failure is by promoting competition/removing barriers to entry. However, in some markets – notably characterised by natural monopoly – competition will not be possible. In such circumstances, economic regulation (such as price control) is an appropriate tool to remedy the market failure.

44. The Discussion Document details clearly the reasons why this is the case:

... there are some markets where there is little or no scope for competition. This occurs particularly in markets with natural monopoly characteristics; that is, where there are economies of scale, sunk costs and barriers to entry such that it is only economic for one firm to supply the market. Such markets typically occur for basic infrastructural or utility services where substitutes are not readily available.

In these markets the basic dynamic of competition, or the threat of competition, is absent. The effect of this is that a natural monopolist will have the incentive and scope to raise price and restrict the quantity and/or quality of the good or service offered. In other words, an unregulated natural monopoly could earn very substantial profits, or 'monopoly rents', since consumers will be willing to pay prices well above cost as there is no alternative supply. This is especially true in the case of 'essential services' such as electricity, where electricity lines businesses have strong natural monopoly characteristics. These 'monopoly rents' are considered by many to be unfair and potentially inefficient, especially when they occur in the supply of essential services.¹¹

As far as the Ministry is aware, prices for basic infrastructural services with monopoly characteristics are controlled in some way in all other OECD countries.¹²

45. Similarly, the Questions and Answers material to the Commerce (Controlled Goods or Services) Amendment Bill 1999 noted *"... natural monopolies ... only have weak incentives to minimise costs and prices ... If this problem is not addressed, consumers will face unduly high prices and/or inferior service ... The objective is to ensure ... strong incentives to be efficient, akin to competition."*

¹¹ Paragraphs 55 and 56 of the Discussion Document.

¹² Paragraph 89 of the Discussion Document.

2. 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?

46. Mighty River Power considers that the sole and primary objective of the regulatory regime should be to promote the long-term benefit of consumers. The terms of reference for MED's review of the regulatory control provisions in the Commerce Act (13 September 2006) are explicit about this:

The overarching objective, in reviewing the regulatory control provisions of the Commerce Act, is to ensure that the imposition of regulatory control is consistent with providing for the long-term benefit of consumers within New Zealand.

47. Promotion of long-term benefits of consumers includes that both efficiency and consumer protection (distribution) are taken into account. From the perspective of a consumer, it makes no difference whether a price decrease is due to an improvement in efficiency and/or reduction in monopoly rents. A dollar saved is a dollar saved.

48. As TelstraClear has noted:¹³

Wealth transfers from producers to end-users comprise a long-term benefit to end-users and, accordingly, must be considered by the Commission. Although the concepts "long-term benefit" and "efficiency" overlap, the former is a broader concept. End-users will benefit from a reduction in price, regardless of whether that reduction is due to:

- a. a reduction in economic profits (that is, wealth transfer from producers to consumers); or
- b. efficiency improvements.

A sustained reduction in price is a "long-term" benefit.

49. Mighty River Power agrees with the Discussion Document that economic regulation should seek to mimic the outcomes that would occur in a market with workable competition.¹⁴ We also agree that *"... competitive markets maximise both efficiency and consumer welfare (by limiting monopoly rents)."*¹⁵

50. Also as noted in the Explanatory Note to the Commerce (Controlled Goods or Services) Amendment Bill 1999 *"... the aim of the Bill is to subject businesses which face limited competition, and electricity lines businesses in particular, to similar pressures and incentives to improve efficiency, prices, and service as those applicable to businesses in competitive markets"*.

51. Promotion of the long-term benefit of consumers accords with such outcomes. This is why the Telecommunications Act objective (s 18) is promotion of competition for the long-term benefit of end-users.

¹³ Paragraph 170 of TelstraClear's *"Submission in Response to Commerce Commission Draft Report Schedule 3 Investigation into Regulation of Mobile Termination"*, 30 November 2004.

¹⁴ Paragraph 57 of the Discussion Document.

¹⁵ Paragraph 85 of the Discussion Document.

52. In a workably competitive market, suppliers are only able to earn 'monopoly profits' (profits above WACC) to the extent, and as long as, they are able to operate more efficiently than their competitors. Suppliers cannot simply improve efficiency and retain monopoly profits. They have to improve efficiency by more than their competitors. As the Discussion Document notes:¹⁶

A competitive market provides strong incentives to invest and innovate efficiently since innovation provides an opportunity to command a premium over competitors, at least for a period of time.

53. Suppliers in a workably competitive market cannot simply hold on to monopoly profits, as if they were some kind of property right. Nor can firms that are first movers in a market expect to be entitled to maintain a monopoly position/ability to extract monopoly profits, e.g. Telecom when it entered the mobile market, and Sky when it set up a satellite-based digital TV service. The operation of price control should be no different.

54. This is precisely why subsections 57E(a) and (c) are explicit that the long-term benefit of consumers is to be achieved, in part, through wealth transfers from ELBs to consumers. As TelstraClear noted *"It is not, for example, sufficient that electricity distribution and transmission businesses improve efficiency (as per section 57E(b))"*.¹⁷ These efficiency gains must be shared with consumers *"including through lower prices"* (as per subsection 57E(c)) and in so doing ELBs *"are limited in their ability to extract excessive profits"* (as per subsection 57E(a)).

55. Some critics of the use of the consumer surplus test (efficiency plus wealth transfers) have attempted to claim the Commerce Commission has been inconsistent in applying a total surplus test for authorisation of business acquisitions and restrictive trade practices, but applying a consumer surplus test for price control (and regulation under the Telecommunications Act). The arguments go something along the lines of: (i) the overall purpose of the Commerce Act (section 1A) refers to the *"long-term benefit of consumers"*; (ii) the Commerce Commission applies a total surplus test for authorisation of business acquisitions and restrictive trade practices under the Commerce Act; therefore (iii) long-term benefit of consumers equates to a consumer surplus test. Mighty River Power rejects this view.

56. The Commerce Commission (appropriately) applies a total surplus test for authorisation of business acquisitions and restrictive trade practices because of the specific wording of the authorisation test in Part 5 of the Commerce Act. Part 5 of the Commerce Act requires the Commission to grant an authorisation where it is satisfied that the practice or acquisition is likely to result in a benefit to the *"public"* that would outweigh any lessening of competition. The term *"public"* refers to the New Zealand as a whole, so a wealth transfer from producers

¹⁶ Paragraph 61 of the Discussion Document.

¹⁷ Paragraph 184 of TelstraClear's *"Submission in Response to Commerce Commission Draft Report Schedule 3 Investigation into Regulation of Mobile Termination"*, 30 November 2004.

to consumers (or vice versa) is deemed to be neutral.¹⁸ Section 1A of the Commerce Act does not override this requirement.

57. Mighty River Power **notes** that we support the use of a consumer surplus test in the application of regulatory control.

¹⁸ For a more detailed discussion of this matter refer to section B.4 of TelstraClear's "*Submission in Response to Commerce Commission Draft Report Schedule 3 Investigation into Regulation of Mobile Termination*"; 30 November 2004.

7 PURPOSE STATEMENT

Chapter 5: Purpose statement

1. In your opinion, is a regulatory-specific purpose statement desirable?

58. Yes. Mighty River Power agrees that a regulatory-specific purpose statement is desirable for Parts 4, 4A and 5 of the Commerce Act, and the purpose statement should be the same for each of these Parts.¹⁹ The price control purpose statement specifically addresses those circumstances where, due to the absence of workable competition, promoting competition is not a viable option.

59. By intentional design Parts 4 and 4A are different mechanisms for determining whether to introduce price control. However, one glaring difference which cannot be explained by policy intent is that 4A includes a purpose statement (section 57E), while Part 4 does not. Instead Part 4 is reliant on the Commerce Act's general purpose statement.

60. We agree with the Discussion Document that the Commerce Act's general purpose statement is not appropriate for Part 4 as it goes to the promotion of competition. It is axiomatic that price control does not promote competition. Part 4 is intended for markets where competition is limited. As the Discussion Document notes:

Most of the Commerce Act is designed to maintain and promote competition by prohibiting or restricting anti-competitive conduct (Part 2) and restraining business acquisitions which substantially lessen competition unless there are net public benefits (Part 3). However, there are some markets where there is little or no scope for competition, such as natural monopolies.²⁰

The regulatory provisions of the Commerce Act do not fit easily with the overall purpose of the Commerce Act (to *promote competition* in markets for the long-term benefit of consumers). The regulatory provisions exist because there are markets where effective competition is not possible and therefore 'promoting competition' will not benefit the economy and/or consumers.²¹

61. The section 1A purpose statement is therefore only indirectly relevant to Part 4 (or 4A). That indirect relevance pertains to the underlying policy behind section 1A. Namely that:²²

- a. Competition is the most effective means to achieve long-term consumer welfare in most cases; and
- b. Where there is little or no competition the object of economic regulation is to mimic, to the extent possible, the outcomes that would occur in a market with workable competition.

¹⁹ As per paragraph 86 of the Discussion Document.

²⁰ Paragraph 3 of the Discussion Document.

²¹ Paragraph 84 of the Discussion Document.

²² Discussion Document at paragraphs 53 and 57.

62. The connection is therefore one of outcome. That is, although natural monopolies can not be made to be competitive they can be encouraged to be more efficient and customer focused.
63. Mighty River Power also agrees a regulatory-specific purpose statement is desirable to remove the confusion associated with the application of section 3A. Although section 3A only provides that efficiency considerations are a mandatory relevant consideration in relation to determining a benefit to the public, it may create the impression that efficiency considerations should dominate distributive considerations. Accordingly, Mighty River Power considers that the clarifying of the relationship between efficiency and consumer welfare as it applies to price control is timely.

2. 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.

64. Mighty River Power supports the proposed purpose statement. The only changes that we advocate amount to fine-tuning.
65. The proposed purpose is based on the purpose statement in s 57E of Part 4A, which we consider to be fundamentally sound. It provides clear direction that price control should be operated for the long-term benefit of consumers (both through efficiency improvements, and transfers of excess monopoly profits from suppliers), and (implicitly) signals that incentive-based price control (such as CPI-X) is more appropriate than rate of return regulation. The purpose is also consistent with the Government's most recent section 26 statement on the operation of price control.²³
66. Section 57E also has the advantage of being clear and unambiguous. The section was subject to judicial interpretation in *Unison Networks Limited v Commerce Commission & Powerco Ltd*²⁴ in which the High Court held that s 57E may be broken into three parts:²⁵
- First there is the statement of purpose: to promote the efficient operation of markets directly related to electricity distribution ... services ...
- Second, is the means of achieving that purpose: ... through targeted control for the long term benefit of consumers.
- Third, is the amplification of that means, in the form of ensuring that the objectives set out in paragraphs (a) to (c) are achieved.
67. In respect of the meaning of s 57E(a) to (c) Wild J stated:²⁶

²³ Government section 26 "Statement to the Commerce Commission of Economic Policy of the Government: Incentives of regulated businesses to invest in infrastructure" (7 August 2006).

²⁴ High Court Wellington, CIV 2004 485 960, 28 November 2005, per Wild J.

²⁵ Ibid at paragraphs 110 to 112.

²⁶ Ibid at paragraph 60.

- a. The goal under s 57E(a) is to ensure that LELBs [i.e., large electricity lines businesses] are limited in their ability to earn profits in excess of their WACC. Put differently, the aim is to limit the ability of LELBs to earn greater than normal profits.
 - b. The s57E(b) aim requires the Commission to direct its actions toward the goals of ensuring that LELBs do not incur unnecessary or wasteful costs, and make appropriate trade-offs between increased quality and cost. Expenditure should be restricted to meeting quality standards required by consumers.
 - c. Section 57E(c) requires the Commission to ensure that efficiency gains when achieved, are shared with customers. Implicit in "sharing" is that the LELB can retain some of the gain. The sharing could take the form of lower prices or of improved quality of service or a combination of the two.
68. Sticking closely to s 57E also has the added benefit of minimising unnecessary regulatory changes. The closer the new Part 4 purpose resembles the existing Part 4A purpose (which has faced Court action over its interpretation) the greater certainty there will be as to the meaning of the purpose.
69. The introductory words to the proposed Part 4 purpose are essentially a generalised version of Part 4A. In generalising the introductory words, the proposal includes *"where there is little or no competition"*. This terminology is new. The more standard wording used in the Commerce Act, and various other pieces of legislation such as the Telecommunications Act 2001, is to refer to markets where *"competition is limited"* - for example, the existing price control tests in section 52 of the Commerce Act.
70. The Discussion Paper asserts, without analysis that "little" creates a higher threshold than "limited". At first blush we agree. However, we consider this issue finely balanced so we set out our analysis of the matter. A notable point in favour of retaining the phrase "limited competition" is that it has an accepted meaning.²⁷
71. As MED is aware the question of the meaning of "little" and "limited" is a matter of statutory interpretation. The first rule of statutory interpretation is that the words of a provision must be given their plain and natural meaning.²⁸ In doing this it is permissible to refer to a dictionary or other standard work of reference.²⁹ Where a provision is unclear it is necessary to enquire as to the purpose of the legislation in which it is contained to determine the meaning of the provision.³⁰ The purpose of a provision is to be determined with reference to

²⁷ For example, the Commerce Commission interpreted the phrase "limited competition" in the local loop unbundling proceeding under the Telecommunications Act.

²⁸ *Williams v Hutt Valley and Bays Fire Board* [1967] NZLR 123 (CA) at 129; *Accident Compensation Commission v Kivi* [1980] 2 NZLR 385 (CA) at 389.

²⁹ *King-Ansell v Police* [1979] 2 NZLR 531 (CA) at 539.

³⁰ Interpretation Act 1999, section 5(1).

the Act as a whole and in its context.³¹ This task is made easier where there is a specific purpose statement.

72. The Concise Oxford Dictionary provides:³²

“Little”

- a. Small in size, amount, degree etc; not great or big ...
- b. Short in stature (*a little man*), of short distance or duration (*go a little way with you ...*)
- c. A certain although small amount of (*give me a little butter*).
- d. Trivial; relatively unimportant (exaggerates every little difficulty).
- e. Not much; inconsiderable (*gained little advantage from it*)

“Limited”:

- a. Confined within limits;
- b. Not great in scope or talents (*has limited experience*);
- c. Few, scanty, restricted (limited accommodation), restricted to a few examples (*limited edition*).

73. The above considered the two words have a variety of meanings, some of which are the same and some of which are not. For example, both can be taken to mean small in scope or amount. However, “limited” appears, to have a broader scope than “little” in respect of its ability to describe the size or effectiveness of something. Something may be limited, but not little. For example, on a purely literal interpretation, competition may be limited in that it falls short of perfect competition, but somewhere greater than little. This suggests that use of the word “limited” to define a test for the degree of competition in a market may create a lower threshold compared to the word “little”. The Discussion Document appears to come to this conclusion, where it states:³³

The **competition test** (whether competition is limited or likely to be lessened) is relatively low. It likely applies to many markets in New Zealand, including many where control is clearly undesirable, and thereby fails to provide certainty for businesses as to when regulation will likely be imposed.

74. However, despite the broader literal meaning of “limited” vis-à-vis “little”, there may be no practical difference between the two words as they apply to Parts 4 and 4A of the Commerce Act. This is because “limited competition” already has an established meaning as a threshold for regulatory action. For example, under the Telecommunications Act, the threshold for regulation is whether the infrastructure owner faces limited, or is likely to face lessened,

³¹ *Donselaar v Donselaar* [1982] 1 NZLR 97 (CA) at 114.

³² Concise Oxford Dictionary, Eighth Edition 1990, Clarendon Press Oxford.

³³ Discussion Document at page 30.

competition.³⁴ The Commerce Commission stated in the Final Report into local loop unbundling:³⁵

The markets in which LLN and fixed PDN services are supplied are examined in order to establish whether competition for the supply of those services is likely to be effective. If competition is found to be effective, then it is unlikely to be appropriate to consider regulation of those services, either in the form of specification or designation.

If, however, it is found that competition in the LLN and fixed PDN markets is not yet effective, then specification or designation of those services *may* be in the long-term interests of end-users. In other words, the finding of limited competition in a market is regarded as being a necessary though not sufficient condition for a regulatory intervention (in the form of specification or designation) to be for the long-term benefit of end-users, compared to an appropriate counterfactual.

75. The Commerce Commission, therefore, interprets “limited” competition as the absence of effective competition or workable competition. It seems unlikely this interpretation will change irrespective of whether the Commission uses “limited” or “little” as the threshold test for regulation. As noted by MED in the Discussion Document (referring to the “little or no competition” and “substantial degree of market power” options:³⁶

While the above options are ‘tougher’ tests than the current test for when control may be imposed (‘competition is limited or likely to be lessened’), it is expected that the decisions would not necessarily differ from those that have been made to date on whether control should be imposed.

76. The intimation here is that it does not really matter whether the test is “limited” or “little”, the Commission will likely apply an effective/workable competition test (which we agree with). Mighty River Power favours the term “limited competition” because this is the term that is already used under the Commerce Act.

77. The other new part of the terminology is the reference to there being “*little or no competition or prospect of competition*”. Mighty River Power generally supports this terminology. However, we consider that it should be slightly modified to increase its clarity. As it stands, use of the second “or” may suggest that not all elements of the phrase need to be satisfied before the Commission can regulate. That is, the Commission may recommend regulation where there is little competition but there is the prospect of competition. In our view this outcome would be inappropriate. Price control is not the appropriate regulatory vehicle where there is a prospect of competition. For this reason we consider that the opening statement should be amended to read:

... in markets where there is little or no competition and there is little or no prospect of competition

...

³⁴ See for example, Telecommunications Act, Schedule 1, Part 2.

³⁵ Commerce Commission, Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network, Final Report, December 2003 at paragraphs 310 and 311.

³⁶ Discussion Document at paragraph 97.

78. This statement implicitly reflects that there may be no competition because of barriers to entry. That being the case, the appropriate regulatory intervention is to remove the barriers to competition (directly address the market failure) rather than impose price control (which would only address the symptoms of the market failure).

79. The reference to “electricity distribution and transmission services” in the existing s 57E indicated that price control was focused on firms with market dominance or a substantial degree of market power. Saying competition is limited is not the same as saying that a firm has market dominance or a substantial degree of market power. This is because there are markets where competition is limited, that have a single dominant firm and various small competitors. We consider that the opening part of the proposed purpose statement should be further amended to reflect this:

Any regulation under this Part should seek to ensure that suppliers with market dominance [a substantial degree of market power]...

80. Also, in generalising the introductory words, a subtle change has been made around the requirements (the subparts) for how the purpose will be achieved. The introductory words in s 57E state that the purpose is to be achieved “*by ensuring that suppliers*”. The proposed Part 4 purpose instead states “*Any regulation should seek to ensure that suppliers*”. There are two subtle but material shifts. The first is the removal of the word “*by*” which provides s 57E with a clear and direct link between the purpose (the introductory words) and the means by which this is to be achieved (the subparts). The second is the addition of the word “*should*” which suggests the Commerce Commission is being given greater discretion as to the extent to which satisfaction of the subparts is used to achieve the purpose. Mighty River Power does not consider either of these shifts to be an improvement or desirable.

81. The introductory wording could be improved along the following lines:

The purpose of this Part is to promote the long term benefit of consumers within New Zealand by providing for regulatory control of markets where there is little or no competition and there is little or no prospect of competition by ensuring that suppliers with market dominance [a substantial degree of market power]:

82. Alternatively, the second sentence in the introductory words could be amended to read:

Any regulation under this Part ~~should~~ is to seek to ~~ensure~~ achieve this purpose by ensuring that suppliers ...

83. Subpart (a) has been amended by replacing “*extract*” with “*earn*”. This change is relatively trivial, but if this difference is retained it may result in arguments about the meaning of “*extract*” and “*earn*”, and whether these are intended to mean different things.

84. The most substantive difference is the proposed addition of sub-part (d). The Discussion Document observes that this “*picks up the government’s recent s26 Statement of Economic*

Policy on the importance of investment and innovation for regulated businesses”.³⁷ Mighty River Power supports the addition of subpart (d), which is equally appropriate for ELBs and other (potentially) regulated businesses. We also believe it is consistent with, and implicit in, “*long-term benefit of consumers*”.

85. The Government should also consider the possible addition of a sub-part (e) to the proposed purpose, specified as follows:

(e) are able to fully recover their costs if they are operating as a reasonably efficient service provider.

86. Mighty River Power’s proposed subpart (e) builds on subpart (d). Subpart (d) goes to the matter of incentives, whereas subpart (e) goes to ability. A regulated utility that is able to fully recover their costs if they are operating as a reasonably efficient service provider should have incentives to invest.

87. Paragraph 7 of the section 26 statement states:

7 The Government’s economic policy objective is that regulated businesses have incentives to invest in replacement, upgraded and new infrastructure and in related businesses for the long term benefit of consumers. The Government considers that this objective will be achieved by:
...

b. regulated rates of return being commercially realistic and taking full account of the long-term risks to consumers of underinvestment in basic infrastructure; and

c. regulated businesses being confident they will not be disadvantaged in their regulated businesses if they invest in other infrastructure and services.

88. In our view “*regulated rates of return being commercially realistic ...*” means an ‘efficient service provider’ should be able to earn a normal rate of return (that is, recover its Weighted Average Cost of Capital (WACC)). Our use of the term ‘efficient service provider’ is deliberate. It is a term derived from the Telecommunications Act 2001, and which MED is proposing to adopt in the Distributed Generation Regulations.³⁸ The Commerce Commission has interpreted it to mean:³⁹

An efficient service provider is a provider that produces a given quantity and quality of service at the lowest possible cost.

89. This does not mean the Commerce Commission should guarantee that an inefficient regulated business be able to recover its full WACC, or receive returns in excess of WACC.

90. The notion of enabling regulated businesses to recover their WACC and the cost of future investment is to ensure regulated businesses make necessary investment in their networks.

³⁷ Paragraph 87 of the MED Discussion Document.

³⁸ Draft Electricity Governance (Connection of Distributed Generation) Regulations 2007.

³⁹ Paragraph 34 of the Commerce Commission’s Revised Draft Determination for TSO Instrument for Local Residential Service for period between 1 July 2003 and 30 June 2004 (8 November 2006).

Mighty River Power considers this is an essential requirement to *“the promotion of efficiency in the production and supply or acquisition of the controlled goods or services”* (s 70A(c) of the Commerce Act).

91. Mighty River Power **recommends:**

- a. The Government introduce a purpose statement for Parts 4, 4A and 5 of the Commerce Act.
- b. The Government amend the proposed purpose along the following lines:

The purpose of this Part is to promote the long term benefit of consumers within New Zealand by providing for regulatory control of markets where competition is limited and there is little or no prospect of competition by ensuring that suppliers with market dominance [a substantial degree of market power]:
- c. The Government add a subpart (e) to the proposed purpose along the following lines:

(e) are able to fully recover their costs if they are operating as a reasonably efficient service provider.

8 THE DECISION ON WHETHER TO IMPOSE REGULATION

Chapter 6: The decision on whether to impose regulation

1. Do you agree with the proposed criteria for deciding on whether regulation may be imposed?

92. Mighty River Power has a number of comments on the criteria proposed for determining whether price control may be imposed.
93. Stepping back from the proposed criteria, for the moment, the adoption of a purpose statement can make the need for specific criteria redundant.
94. This is the case with Part 4A of the Commerce Act. Section 57H(c) of the Commerce Act provides that the Commerce Commission is to determine whether to declare control taking into account the section 57E purpose.
95. The Telecommunications Act 2001 also provides an example of this.
96. Under the Telecommunications Act the Commerce Commission may, of its own initiative or at the request of the Minister of Communications, undertake an investigation into whether to recommend to the Minister that any particular telecommunications access service be regulated (designated or specified). The regulation would include service quality, terms and conditions and, if designated, price.
97. The Telecommunications Act does not include specific criteria for determining whether a service should be regulated. Instead it relies on the purpose statement in the Act (s 18). The s 18 purpose statement is:
- (1) The purpose of this Part and Schedules [1](#) to [3](#) 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.
98. Section 19 goes on to state:
- If the Commission or the Minister (as the case may be) is required under this Part or any of [Schedules [1](#), [3](#), and [3A](#)] to make a recommendation, determination, or a decision, the Commission or the Minister must—
- (a) consider the purpose set out in section [18](#); and
 - (b) if applicable, consider the additional matters set out in Schedule [1](#) regarding the application of section [18](#); and
 - (c) make the recommendation, determination, or decision that the [Commission] or Minister considers best gives, or is likely to best give, effect to the purpose set out in section [18](#). The combined application of section 18 and 19 requires that the Commerce Commission only

recommend regulation if it best gives, or is likely to best give, effect to the section 18 purpose:⁴⁰

Making this assessment requires examining the existing market structure and the degree of competition in relevant markets. If competition is workable or effective in those markets, intervention is unlikely to promote competition further and it could impose costs without commensurate benefits. Conversely, if competition is not workable or effective, it is possible that appropriate regulation could promote competition, but this must be subject to an overall assessment of the net costs and benefits of action and the potential indirect costs of regulation.

100. The Commerce Commission has effectively translated the requirements of sections 18 and 19 into the following tests:

- a. Competition is limited (as per s 52(a) of the Commerce Act);
- b. Regulation would *"promote competition in telecommunications markets"*; and
- c. Regulation would be *"for the long-term benefit of end-users of telecommunications services within New Zealand"* (as per s 52(b) of the Commerce Act).

101. The inference that can be taken from the Telecommunications Act is that a well specified purpose statement can act as a substitute for specific tests or criteria for regulation. The other inference that should be taken is that any tests for regulation that are introduced should be consistent with the purpose statement.

102. The purpose statement MED is proposing captures the concept of limited competition, and long-term benefit of consumers. We therefore do not believe that specific tests are required as well.

103. Mighty River Power **recommends** that section 19 of the Telecommunications Act 2001 be adopted for Parts 4 and 4A of the Commerce Act, along the following lines:

If the Commission or the Minister (as the case may be) is required under this Part to make a recommendation, or a decision, the Commission or the Minister must—

- (a) consider the purpose set out in section [x]; and
- (b) make the recommendation, determination, or decision that the [Commission] or Minister considers best gives, or is likely to best give, effect to the purpose set out in section [x].

On the assumption that the Government decides not to rely on the purpose statement for determining whether economic regulation should be introduced under the Commerce Act, Mighty River Power has a number of comments on the Discussion Document's draft criterion.

105. Our first comments relate to the competition criterion. The Discussion Document proposes two possible criterion:⁴¹

[Goods or services may be regulated if:]

Option A

⁴⁰ Paragraph 205 of the Commerce Commission's Final Report [LLU], December 2003.

⁴¹ Paragraph 96 of the Discussion Document.

There is little or no competition or prospect of competition in the relevant market

Option B

The goods or services are supplied by a person or persons with a substantial degree of market power.

106. The wording in option A parallels the proposed wording in the purpose to Part 4. It is appropriate for the wording to be the same, but the wording suffers from the same shortcomings as the proposed purpose. If option A is introduced, and our recommendations for the purpose in Part 4 are adopted, we are of the view that option A should be amended to read:

... where there is little or no competition and there is little or no prospect of competition...

107. Leaving aside the matter of the drafting of option A, it suffers from one other problem. There can be competitors in markets where competition is limited/there is little competition. Limited competition does not mean there is only one (monopoly) supplier. As noted by the Commission "*a market with limited competition is not necessarily a market with no competition*".⁴²

108. For example, the Commerce Commission has determined that competition is limited in a large range of telecommunications markets, notwithstanding that there are several competitors in the market.⁴³ The typical characteristic of these markets is one supplier, Telecom, with substantial market power or market dominance, and several small suppliers that compete against Telecom and have no market power. The wording of option A would encompass not only Telecom or the dominant supplier, but also other market participants. Clearly, this would not be appropriate.

109. What this means is that option B should not be adopted on its own.

110. A supplier may have substantial market power in a market where there is workable competition (so the option B test is satisfied, but the option A test is not satisfied). Price control may not be appropriate in such circumstances, as it could be detrimental to competition. Rather the appropriate regulatory response may be to reduce barriers to competition. This could be addressed by adopting both options A and B. (Which the Discussion Document's draft purpose statement effectively does.)

111. Mighty River Power **recommends** that if our recommendation to adopt section 19 of the Telecommunications Act is rejected:

a. Option A be amended to read:

⁴² Page 13 of the Commerce Commission in its Final Report, Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network, dated December 2003.

⁴³ For example, the Commerce Commission in its Final Report, Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network, dated December 2003, found that there was limited competition in the wholesale market for local loops despite there being entry by TelstraClear and several wireless operators (see page i and 102).

where competition is limited or there is little or no prospect of competition

b. The competition criterion includes both options A and B.

112. The second part of the test for determining that price control may be introduced is the efficiency and distributional tests or criteria.

113. The Discussion Document proposes:

Goods or services may be regulated if economic regulation is necessary or desirable to:

(a) promote efficiencies in a market; or

(b) provide long term benefits to persons acquiring the goods or services that [substantially] [clearly] exceed the direct and indirect costs of regulation.

114. There are a number of differences between the proposed efficiency and distributional tests, and the proposed purpose statement:

a. The reference to efficiency;

b. The reference to “persons acquiring the goods or services” rather than “consumers”;

c. The reference to the “direct and indirect costs of regulation”.

115. Mighty River Power does not believe it is appropriate for the tests for economic regulation to differ from the purpose of economic regulation. It could result in a situation where price control is introduced because the tests for control have been satisfied, even though control is contrary to the purpose statement. This situation could arise, for example, where the person acquiring the goods or services is a foreign-owned company, e.g. an overseas airline where control is being considered for an international airport.

116. Each of the three points of difference is discussed in turn below.

117. If efficiency is promoted then, *ceteris paribus*, the long-term benefit of end-users will also be promoted. The explicit reference to efficiency in the price control tests may act to heighten the emphasis on efficiency. This could also be achieved through the purpose statement, just as it is under section 18(2) of the Telecommunications Act:

(2) In determining whether or not, or the extent to which, any act or omission will result, or will be likely to result, in competition in telecommunications markets for the long-term benefit of end-users of telecommunications services within New Zealand, the efficiencies that will result, or will be likely to result, from that act or omission must be considered.

118. Given Mighty River Power believes specific tests for economic regulation should not be included in the Commerce Act (the purpose statement should instead be relied on), Mighty River Power considers that Parts 4 and 4A should adopt section 18(2) of the Telecommunications Act. Mighty River Power **recommends** that, if the Government decides to increase the emphasis on efficiency in Parts 4 and 4A, section 18(2) of the Telecommunications Act be adopted to the Parts 4 and 4A purpose statement along the following lines:

In determining whether or not, or the extent to which regulated control will be for the long-term benefit of consumers in New Zealand, the efficiencies that will result, or will be likely to result, from regulated control must be considered.

119. Mighty River Power does not believe the purpose statement and economic regulation tests should refer to different classes of customers. If it is appropriate for the tests to refer to the “*long term benefit of persons acquiring the goods or services*”, rather than “*long term benefit of consumers*”, then the purpose should be amended to reflect this, and vice versa.

120. Mighty River Power considers the reference to “*exceed the direct and indirect costs of regulation*” to be superfluous. The Commerce Commission already takes into account direct and indirect costs in price control investigations. In its decision not to place Unison under control, the Commerce Commission noted:⁴⁴

The potential net benefits of control to consumers over time are the benefits of control, less the direct and indirect costs of control.

121. Regulated control will not be to the long-term benefit of end-users if the direct and indirect costs of regulation exceed the benefits.

122. This is reinforced by looking at the Telecommunications Act. The purpose in section 18(1) of the Telecommunications Act states:

(1) The purpose of this Part and Schedules 1 to 3 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.

123. There is no reference to direct or indirect costs. This reflects that long-term benefits equate to benefits less direct and indirect costs. Each investigation that the Commerce Commission has undertaken, measuring the long-term benefits to end-users, has calculated long-term benefits in this way.

124. The other observation we have is that there is an inconsistency between subpart (b) and the proposed purpose to Part 4. The proposed purpose refers to the long-term benefit of end-users, not “*persons acquiring the goods or services*”, who might be intermediate suppliers.

125. Mighty River Power **recommends** that, if our previous two recommendations are not adopted, the proposed efficiency and distributional tests or criteria should be amended as follows:

Goods or services may be regulated if economic regulation is necessary or desirable to provide long term benefits for consumers in New Zealand.

or

Goods or services may be regulated if economic regulation is necessary or desirable to provide long term benefits for consumers in New Zealand.

⁴⁴ Paragraph 2.43 of Commerce Commission “*Reasons for not declaring control – Unison Networks Limited*”, 11 May 2007.

In determining whether or not, or the extent to which regulated control will be for the long-term benefit of consumers in New Zealand, the efficiencies that will result, or will be likely to result, from regulated control must be considered.

2. 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?

126. In the above discussion we noted that the long term benefit to consumers/end users test carriers an implicit assumption as to direct and indirect costs. Leaving this aside, the question remains whether there should be some kind of threshold on the extent to which benefits need to exceed costs, or on the surety of benefits exceeding costs, before regulation is introduced. The question implies that there are asymmetric risks of regulation, i.e. the risks from regulating when regulation should not have been introduced exceed the risks of not regulating when regulation should be introduced.

127. Mighty River Power does not believe there is any need to explicitly specify a burden of proof in the efficiency and distributional tests or criteria. So long as the Commerce Commission is acting to satisfy the proposed Part 4A purpose, it will act to make the appropriate judgement around the burden of proof.

128. It is notable that no such threshold exists in the Telecommunications Act.

129. In submissions made to the Commerce Commission on its Local Loop Unbundling (LLU) investigation⁴⁵, Telecom nevertheless claimed the Commission could only recommend regulation (in the form of unbundling) where the evidence satisfies the Commission on (at least) the balance of probabilities.⁴⁶ Telecom relied on *Foodstuffs (Wellington) Cooperative Society Ltd v Commerce Commission*⁴⁷ to support its argument. Telecom subsequently submitted to the Commerce Commission, on its investigation into whether to regulate fixed-to-mobile termination rates⁴⁸, that the Commerce Commission should apply a high burden of proof for any regulatory intervention.

130. Mighty River Power believes a *high standard of proof* should be applied to the decision whether to introduce regulation. The appropriate level of proof (how high is high?) will vary

⁴⁵ Under section 64 of the Telecommunications Act.

⁴⁶ Telecom, *Telecom's supplementary submission on legal issues*, submitted at the Commission's conference, paragraphs 14-17.

⁴⁷ [1992] 4 TCLR 713 at 721.

⁴⁸ Telecom, Submission in respect of the Commerce Commission's Draft Report for its Schedule 3 Investigation into Regulation of Mobile Termination, 30 November, paragraphs 85-86; Vodafone, *Submission on the Schedule 3 Investigation into Regulation of Mobile Termination Draft Report*, 30 November 2004, paragraphs 8-11.

depending on the nature of the regulatory problem, and the nature of the potential regulatory solutions. Mighty River Power contends the appropriate burden of proof should be:

- a. Higher where there is a high level of uncertainty surrounding the potential costs and benefits of intervention. Every uncertainty should count directly and clearly against intervention.
- b. Higher where the regulatory intervention may (negatively) impact or interfere with the natural competitive operation of the affected market(s).
- c. Higher where there is an asymmetry of risk between the potential benefits and costs ie where 'bad' regulation would likely have a greater negative impact than the benefit of 'good' regulation.

131. In both the Commerce Commission's LLU and fixed-to-mobile termination rate investigations the Commission stated that it *"does not consider that there is a need to import a notion of burden of proof into its processes under the [Telecommunications] Act"*, and instead it simply needed to *"make the recommendation that best gives, or is likely to best give, effect to the purpose set out in section 18."*⁴⁹ Implicitly the Commission has actually made such a judgement. In the LLU preceding, for example, the Commission concluded that there were net benefits of regulating LLU. It quantified positive net benefits (\$30.1m excluding dynamic efficiency impacts), and made a qualitative assessment that dynamic efficiency effects would be positive. Despite this the Commission recommended against regulation on the basis that it did *"not consider that the size of the potential gains warrant intervention at this stage"*,⁵⁰ i.e. the benefits to did exceed the costs by a sufficient amount.

132. Mighty River Power **notes** that we consider it unnecessary to explicitly specify a burden of proof for regulatory control in the efficiency and distributional tests and criteria.

3. 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)?

133. Mighty River Power considers this to be a methodological matter for the Commerce Commission when undertaking a Cost Benefit Analysis (CBA) to determine whether or not to introduce economic regulation. We do not consider this to be a matter that is relevant to the review of the economic regulation provisions in the Commerce Act.

⁴⁹ *"Telecommunications Act 2001: Schedule 3 investigation into regulation of mobile termination: Final Report"*, 9 June 2005.

⁵⁰ Paragraph 795 of the Commerce Commission's Final Report, *"Telecommunications Act 2001: Section 64 Review and Schedule 3 Investigation into Unbundling the Local Loop Network and the Fixed Public Data Network"*, 22 December 2003.

134. As a general rule, the Commerce Commission should assume that competition will result in pass-through to end-users. We note though that in its investigation of whether to regulate mobile termination rates under the Telecommunications Act (which have been undertaken under Part 4A of the Commerce Act)⁵¹ the Commerce Commission assumed there would not be 100% pass-through, and that there would be lags in the pass-through.⁵² This meant that the net benefits the Commerce Commission estimated for regulation of mobile termination rates were lower than they would otherwise have been.

4. Should the current provisions in the Act allowing control to be imposed in the interests of suppliers (to a monopsonist) be retained?

135. Mighty River Power reiterates the point we made, in relation to question 1, that the purpose statement and economic regulation tests should refer to different classes of customers. If it is appropriate for the tests to refer to the “long term benefit of persons acquiring the goods or services”, rather than “long term benefit of consumers”, then the purpose should be amended to reflect this, and vice versa.

5. Do you agree that there should not be a legislative test for when regulation should be imposed?

136. Mighty River does not agree that there should not be a legislative test for when regulation should be imposed. Mighty River Power has two comments in relation to whether the legislation test for economic regulation should be a “may” or “should” (more accurately a “must” test).

137. First, if the purpose/economic regulation tests have been robustly specified it is difficult to see why additional discretion should be needed as to whether economic regulation should be introduced. If the Commerce Commission and the Minister both believe competition is limited, there is little or no scope for competition to develop and economic regulation would be to the long-term benefit of consumers it is difficult to see why economic regulation should not be introduced. The Discussion Document suggests that *“The reasons for this is [sic] to retain flexibility for the Minister to take into account wider policy matters and to retain the presumption that regulation is a last resort.”* The Discussion Document lists as potential examples *“... effects on business confidence, effects on overseas investors, credibility of the overall regulatory regime and so forth.”*

138. Mighty River Power is of the view that all of these examples, and any other appropriate policy considerations, fall within the ambit of *“long-term benefit of consumers of New Zealand.”* If they did not the Minister would not be able to consider them. This is because the Minister is still bound by the Commerce Act in respect to what he or she may decide, irrespective of

⁵¹ TelstraClear “Submission in Response to Commerce Commission Draft Report: Schedule 3 Investigation into Regulation of Mobile Termination, Public Version, 30 November 2004.

⁵² Commerce Commission, “Final Report, Schedule 3 Investigation into Regulation of Mobile Termination” 9 June 2005 at page 120.

whether there is a specific provision detailing the boundaries of his or her power. Parliament does not countenance arbitrary power.⁵³ Powers must be used to promote the policy and objects of the empowering Act.⁵⁴

139. Second, the approach taken under the Telecommunications Act is again relevant. The Telecommunications Act takes a “must” approach. Section 19 of the Telecommunications Act states:

If the Commission or the Minister (as the case may be) is required under this Part or any of [Schedules [1](#), [3](#), and [3A](#)] to make a recommendation, determination, or a decision, the Commission or the Minister must—

- (a) consider the purpose set out in section [18](#); and
- (b) if applicable, consider the additional matters set out in Schedule [1](#) regarding the application of section [18](#); and
- (c) make the recommendation, determination, or decision that the [Commission] or Minister considers best gives, or is likely to best give, effect to the purpose set out in section [18](#).

The combined application of section 18 and 19 requires that the Commerce Commission only recommend regulation if it best gives, or is likely to best give, effect to the section 18 purpose. Mighty River Power can see no reason why the Telecommunications Act should contain a “must” requirement for whether to introduce regulation, while the economic regulation provisions in the Commerce Act contain a “may” requirement.

141. Recent experience with the Minister of State-Owned Enterprises (on behalf of the Minister of Communications) on the decision over whether or not to regulate mobile termination rates provides a useful illustration of why a “must” requirement is suitable, and that it provides the Minister with ample discretion. The Telecommunications Commissioner made a recommendation in favour of regulation. The Minister could reject the Telecommunications Commissioner’s recommendation if he disagreed as to whether it best gives, or is likely to best give, effect to the purpose set out in section 18. The Minister ended up rejecting the recommendation on the basis that he considered undertakings from Telecom and Vodafone would better satisfy the purpose.

142. The appropriate point of discretion is over whether the purpose/tests have been met; that is whether the Minister considers regulation best gives, or is likely to best give, effect to the purpose.

143. Mighty River Power’s recommendation that section 19 of the Telecommunications Act be adopted into Parts 4 and 4A of the Commerce Act would provide the Minister of Commerce with appropriate discretion over whether he or she accepts or rejects the Commerce Commission’s recommendations as to whether to introduce economic regulation.

⁵³ *Entick v Carrington* (1765) 2 Wils 275; 95 ER 807; 19 State Tr 1029; *Ministry of Transport v Payn* [1977] 2 NZLR 50 (CA).

⁵⁴ See *Laws of New Zealand*, Administrative Law (3) Illegality / Abuse of Discretionary Power / Improper purpose/ 28. Construing the purpose of the empowering enactment (LexisNexis NZ Limited).

6. 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?

144. Mighty River Power believes the Minister should be the decision-maker on whether control is imposed under Part 4 of the Commerce Act. However, Mighty River Power does not believe the Minister should be able to make a decision to recommend price control absent a recommendation from the Commerce Commission that the Minister do so. This corresponds with the approach required under the Telecommunications Act. Section 68(1) of the Telecommunications Act states that the Minister of Communications must not make a recommendation to the Governor-General to make an Order in Council to regulate a service unless the Minister accepts the Commission's recommendation that the service be regulated.

145. Mighty River Power **recommends** that the Minister of Commerce continue to be responsible for deciding whether to introduce economic regulation, but that the Minister should only be able to introduce economic regulation following a recommendation from the Commerce Commission that the Minister do so.

7. Do you agree that the decisions on whether and, if so, how to regulate should be undertaken simultaneously rather than sequentially?

146. Yes. Mighty River Power agrees with the proposal that decisions on whether to introduce price control and how to regulate should be undertaken simultaneously rather than sequentially.

147. A sequential approach can create a 'chicken and egg' type problem for the Commerce Commission. The Commission cannot prejudge what the nature of the price control should be, but whether price control should be introduced, and the costs and benefits of price control, depend on the type of price control that the Commerce Commission would introduce. The Commerce Commission therefore has to make an assumption, even if implicit, about the type of price control it would introduce when measuring the potential benefits of introducing price control.⁵⁵

148. The existing requirement for a sequential approach means – under Part 4 where the Minister of Commerce makes the decision on whether to accept a recommendation for price control – the Minister will be making his or her decision under uncertainty, as to the form of price control. The sequential approach also results in the process for any price control investigation being extended.

⁵⁵ This was a dilemma for the Commerce Commission that Mighty River Power raised at the Commission's public hearings into its draft intention to impose price control on Unison, 17 November 2005. The transcript can be found at:

<http://www.comcom.govt.nz//IndustryRegulation/Electricity/ElectricityLinesBusinesses/TargetedControl/ContentFiles/Documents/Unison%20Conference%20Transcript%20-%2017%20November%202005.pdf>

149. Investigations into whether to regulate (specify or designate) services under the Telecommunications Act 2001 provides a useful parallel to price control investigations. The Telecommunications Act requires that the Commerce Commission not only make a recommendation on whether to regulate the service, but also on the form of that regulation, i.e. description of service, conditions of supply, definition of access providers and seekers, access principles and limits on the access principles, and any other additional matters. incentives to invest. These are not done sequentially.
150. Mighty River Power **recommends** that the Government amend the Commerce Act, as proposed in the Discussion Document, to enable the decision on whether to impose price control to be made at the same time as the decision on how to price control, rather than sequentially.

9 TYPES OF ECONOMIC REGULATION

Chapter 7: Types of economic regulation

1. Do you agree that it is desirable to widen the scope of the Commerce Act by providing for regulatory options other than control, specifically:

- negotiation/arbitration and
- price monitoring/information disclosure?

151. Mighty River Power is comfortable with the “*economic regulation*” tools in the Commerce Act being widened. We have no issue with information disclosure, a generic Part 4A and a negotiate/arbitrate regime per se. The concern we have is that widening the range of economic regulation tools would complicate decision making processes. It would also increase regulatory uncertainty. Firms could have less certainty as to the type of regulation that may be imposed and decisions using different regulatory tools would provide less precedent value for other decisions. Additional tools should only be introduced if there are considered to be clear benefits.

152. The addition of these tools would necessitate that the Commission consider which option would best give effect, or likely best give effect, to the (new) purpose of Part 4, when undertaking an investigation under Part 4 of the Commerce Act. Consequently, the same tests should be required for each of these options, and they should not have a lesser test than price control.

153. One matter MED should consider, in relation to the addition of these tools, is the treatment of the existing information disclosure regimes. Presently, information disclosure provisions exist in electricity (administered by the Commerce Commission), telecommunications (also administered by the Commerce Commission), gas (administered by Minister of Energy), airports (administered by the Minister of Transport), and kiwifruit (administered by the Minister of Agriculture and Forestry). If information disclosure provisions are added to the Commerce Act (beyond the existing electricity provisions), Mighty River Power is of the view that responsibility for the existing information disclosure regimes should be transferred to the Commerce Commission in the same way as they were for electricity and telecommunications.

154. Mighty River Power also believes that if MED considers information disclosure could beneficially be extended to new sectors, it should also make sure that the information disclosure regime that it currently administers for gas is up-to-date, and as robust as possible. To that end, the Commerce Commission’s criticisms of the quality of information disclosed under the Gas (Information Disclosure) Regulations 1997:⁵⁶

⁵⁶ Commerce Commission, “Gas Control Inquiry, Final Report” 29 November 2004 at paragraph 95..

In addition, the Commission notes the poor quality of business specific data available through the Gas (Information Disclosure) Regulations 1992 [sic]. The Commission considers there would be substantial benefits from requiring the businesses to disclose consistent and robust information and therefore, requests that the Minister consider strengthening the gas pipeline information disclosure regime.

155. The Government undertook a substantial review of the Gas (Information Disclosure) Regulations in 1999 – 2000. The changes would greatly improve the Regulations, bringing them closer into line with electricity (for example, through mandatory financial separation and valuation methodologies). The changes were in a form ready to be implemented. It is regrettable that the amendment of the Regulations has now been delayed by the best part of 7 years. They are essentially in a form ready to be implemented, except that aspects of the ODV methodology (Replacement Cost values) will need updating. Mighty River Power believes that the changes should not be held up by the review of the regulatory control provisions in the Commerce Act. The changes are desirable regardless of what amendments are made to the regulatory control provisions in the Commerce Act. Mighty River Power **recommends** that MED implement the changes to the Gas (Information Disclosure) Regulations as a matter of priority, and not allow this to be delayed by the review of the regulatory control provisions in the Commerce Act.

2. 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:

- *meeting the competition criteria only*
- *requiring qualitative (rather than quantitative) cost-benefit analysis?*

156. No. Mighty River Power does not believe specific easier tests should be provided whether light-handed types of regulation may be imposed. The same tests should be applied to each option for economic regulation, be it price control, information disclosure or some other form of regulation.

157. This view is based on:

- a. The practical problems that would arise if the Commerce Commission had to compare different options for economic regulations using different tests;
- b. Application of quantitative CBA is desirable and reflects regulatory best practice; and
- c. The Commerce Commission already has appropriate discretion as to whether it applies a quantitative CBA.

158. The Discussion Document's proposals, if implemented, would mean that the Commerce Commission would have a wider range of "tools" for economic regulation than the present price control. What this would mean is that, when the Commerce Commission undertakes an investigation into whether to recommend to the Minister that economic regulation be introduced, the Commission would need to compare not just price control against the status

quo, but also against the other forms of regulation, to determine “*whether an alternative form of regulation has the potential to offer a more favourable trade-off between costs and benefits than control under Part F*”.⁵⁷

159. To make such a comparison would require the Commerce Commission to apply the same tests and criteria to each of the options for economic regulation. If it did not do so it would have no basis for recommending one form of economic regulation over another.

160. The only exception would be where, say, price control failed its (higher) test, but information disclosure satisfied its (lower) test. But what would happen if price control and information disclosure both passed their respective tests? It could be that both should be introduced or only one.

161. When the Government reviewed the Telecommunications Act, it considered the option of applying an easier test for extending the period that an existing regulated service is regulated for, than the test that was applied for determining whether a service should be regulated in the first place.⁵⁸ The Commerce Commission expressed concern about this proposal, on the basis that “*Introducing a less onerous test would introduce a number of legal uncertainties parties and the Commission to resolve*”.⁵⁹ The same issues would arise with the Commerce Act.

162. Mighty River Power believes that the use of quantitative CBA reflects regulatory best practice.

163. Richardson J observed, in the case of *Telecom v Commerce Commission*:⁶⁰

...the desirability of quantifying benefits and detriments where and to the extent that it is feasible to do so...there is in my view a responsibility on the regulatory body to attempt so far as possible to quantify detriments and benefits rather than rely on a purely intuitive judgment to justify a conclusion that detriments in fact exceed quantified benefits.

164. The passage from the *Telecom v Commerce Commission* case has been cited with approval in a number of subsequent cases including, for example, *Ravensdown Corporation Ltd v Commerce Commission* (High Court, Wellington, AP 168/96, 9 December 1996, Panckhurst J and Professor Lattimore) and *Rugby Union Players' Association Inc v Commerce Commission* (No 2) [1997] 3 NZLR 301.

165. Regardless of any legal requirements, a quantitative CBA is a desirable and beneficial part of regulatory decision making. In support of this view, we note that the Commerce Commission has also stated:

⁵⁷ Box in page 39 of the Discussion Document.

⁵⁸ This matter became academic as the Government removed the “sunset” clause that meant regulation of a service expired after five years.

⁵⁹ Commerce Commission submission to the Ministry of Economic Development “Implementation Review of the Telecommunications Act 2001” dated February 2005 at paragraph 42..

⁶⁰ *Telecom Corporation of New Zealand Limited v Commerce Commission* [1992] 3 NZLR 429 at 447.

The Commission considers that quantitative modelling is useful to the degree that it focuses on key assumptions regarding characteristics of the market and the way in which participants are likely to act, with and without regulation. The Commission's view is that the value of a model is in its ability not to produce 'proof' of the net benefits of regulation, nor to supplant the Commission's exercise of judgment, but rather in providing support to the Commission's deliberations by:

- focusing interested parties on verifiable economic arguments;
- making transparent the values of key parameters and assumptions in the analysis; and
- producing quantitative estimates of the results of proposed regulation.⁶¹

In undertaking its role under the Act, the Commission will need to manage the risks associated with regulatory intervention.

These risks can arise from...the Commission making decisions on the basis of imperfect information...⁶²

166. Mighty River Power agrees with the Commerce Commission's views on the desirability of quantitative CBA. Application of a CBA is also useful for ensuring regulation is only introduced where it is likely to result in clear benefits.

167. The judgement of Richardson J, cited above, does not require the Commerce Commission to apply a quantified CBA in all instances. The judgement expressed the view that quantified CBA was desirable "*where and to the extent that it is feasible*". Nor is there anything in the Commerce Act that states the Commission is required to apply a quantified CBA.

168. It is worth noting that the Commerce Commission has not applied quantified CBA to all aspects of its price control investigations. For example, while it undertook a quantified CBA to determine whether it should impose price control on Unison and Vector, it concluded that it should also regulate on a disaggregated (regional/customer category) basis as well without any quantified CBA to support this conclusion. The Commerce Commission also did not undertake a quantitative assessment of Unison's Administrative Settlement Offer, before deciding to accept the Offer rather than place Unison under price control.

169. Similarly, under the Telecommunications Act, the Commerce Commission applied quantified CBA to its investigations into whether to regulate additional services (LLU and fixed-to-mobile termination rates), but did not do so for its "sunset clause" investigation, into whether existing regulated services should continue to be regulated. This was despite that the tests for both types of investigation were exactly the same (satisfaction of ss 18 and 19 of the Telecommunications Act).⁶³

⁶¹ Paragraph 315 of the Commerce Commission's "Schedule 3 investigation into regulation of mobile termination: Final Report", 9 June 2005.

⁶² Paragraph 71 of the Commerce Commission's "A guide to the role of the Commerce Commission in making access determinations under the Telecommunications Act", 28 May 2002.

⁶³ The Commerce Commission formed the view (paragraph 32 of "*Schedule 3 investigation into the extension of regulation of designated and specified services*"; Draft Report 30 May 2006) that:

In the Commission's previous Schedule 3 investigations, the Commission was required to consider whether there were net benefit effects from the designation or specification of services that were not

170. Mighty River Power believes this illustrates that the Commerce Commission already has appropriate discretion as to whether it applies a quantitative CBA.

171. Mighty River Power **recommends** against different tests being prescribed in the Commerce Act for different forms of economic regulation.

within the regulatory ambit. In contrast, the services under consideration in this investigation are currently regulated. It is the Commission's view that the mere existence of these services in the Act suggests at the time of the enactment of the Telecommunications Act in 2001 it was decided that regulation of these services would be likely to promote competition during the period of designation or specification. For this reason, the Commission has decided not to undertake a quantitative cost-benefit analysis for the purposes of considering whether or not to recommend the extension of currently regulated services for two years. In any event, such an analysis would not have been possible given the tight timeframes for the completion of the review.

10 KEY INPUT DECISIONS

Chapter 8: Key input decisions

1. 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?

2. Is it practical, or possible, to set generic methodologies that could apply to all potentially regulated sectors?

172. Mighty River Power sees value in having key input decisions set as a stand-alone process in advance of any inquiry and recommendation to regulate. This would help to provide greater certainty around the outcome of any investigation, and on how the Commerce Commission would regulate.

173. The merit would depend on the particular key input, and whether it could be generically applied or individual case-specific. The benefits are likely to be much greater for inputs that could be applied generically.

174. There have been several Commerce Commission investigations in a particular industry, where the Commerce Commission has received submissions on generic issues from interested parties in other industries. For example, TelstraClear made a submission on the Unison price control inquiry because they considered that:⁶⁴

... there is substantial commonality of issues in relation to whether to price control Unison and the designation of various services under the Telecommunications Act. For the sake of regulatory certainty and stability, it is important that the Commerce Commission is as consistent as possible (taking into account industry specific factors and differences in the regulatory regimes). We note that various other network utilities have taken a similar interest with telecommunications proceedings, for example, Vector, NGC and Contact Energy all commenting on the Commission's mobile termination.

175. The submission commented favourably on the consistency and appropriateness of the Commerce Commission's approach on matters such as the use of a consumer surplus test, and treatment of indirect costs.

176. Likewise, Telecom has submitted to the Commerce Commission on the matter of whether a consumer or total surplus test should be applied in the price control inquiry into gas pipelines.⁶⁵ Contact Energy did the same on the Commerce Commission's investigation

⁶⁴ TelstraClear, submission to the Commerce Commission "Price Control of Unison Network" dated 21 October 2005 at page 1.

⁶⁵ Telecom submission to Commerce Commission on Gas Control Inquiry dated August 2003.

(under the Telecommunications Act) into whether mobile termination services should be designated.⁶⁶

177. Mighty River Power has made observations about the approach the Commerce Commission has taken in different proceeding under the Commerce and Telecommunications Acts. In a submission on the Unison Price Control inquiry we expressed the view:⁶⁷

... the CC's approach to the calculation of WACC and treatment of indirect costs in the present Unison inquiry differs from that taken in the airport and gas pipeline price control inquiries. This reflects that the CC has adjusted its approach on the basis of submissions made in investigations (mobile termination) and determinations under the Telecommunications Act (TSO net cost determinations and TSLRIC interconnection price determination).

For the sake of regulatory certainty and predictability it is important that these differences and the reasons for these differences are as explicit as possible. Anyone that was not familiar with the telecommunications proceedings, for example, may well have been surprised by the CC's decision not to include indirect costs.

178. Similar cross-overs of issues will also arise in relation to the Commerce Commission's responsibilities under the Dairy Industry Restructuring Act 2001, which provides for an access regime which is not dissimilar to the Telecommunications Act.

179. Mighty River Power believes that it is not efficient for the Commerce Commission to review, and hear submissions, on a matter such as the methodology for calculation of WACC in one investigation (for example, the airports price control inquiry), and then to go through the same review process in another investigation (for example, the subsequent gas price control inquiry and calculation of the net cost of the TSO under the Telecommunications Act). It would be more efficient to review the matter once – consulting with interested parties in all relevant sectors. This would also assist in helping to ensure greater consistency of approach, e.g. the Commerce Commission may change its approach on a key input between inquiries, because it hears new and better submissions in the later inquiries.

180. For more sector specific key inputs, a requirement to make decisions on the key input in advance of an inquiry and recommendation may not be so desirable. For such key inputs such a requirement may be contrary to the Discussion Document's regulatory design principle that *"the regulatory regime is sufficiently flexible to account for firm/industry specific circumstances, changing market conditions, innovation and experience."*⁶⁸ Such a requirement may also achieve little more than adding an extra step in the regulated control process: *"the separation [could be] arguably time-consuming and costly as it requires two,*

⁶⁶ Contact Energy "Submission on the Commerce Commission's draft report on the investigation into the regulation of mobile termination" dated 20 December 2004.

⁶⁷ Paragraphs 17 and 18 of Mighty River Power's Oral Submission to the Commerce Commission in response to the Consultation Paper "Regulation of Electricity Lines Businesses - Targeted Control Regime - Intention to Declare Control - Unison Networks Limited", 17-18 November 2005.

⁶⁸ Bullet 4 of paragraph 23 of the Discussion Document.

*largely duplicative, processes.*⁶⁹ It would be ironic for the Commerce Act to be amended to remove the separate processes and decisions on whether and how control should be imposed only for it to be replaced with separate processes on decisions on key inputs and whether/how to control.

181. Mighty River Power **notes** that:

- a. We see value in having key input decisions, particularly on generic inputs such as WACC, made as a stand-alone process in advance of any inquiry and recommendation to regulate; and
- b. To maximise the benefit of such an approach it should apply across the Commerce Act, Dairy Industry Restructuring Act and the Telecommunications Act.

3. Do you consider that input methodologies should be set:

- *as guidelines by the Commerce Commission;*
- *as Rules by the Minister following a recommendation from the Commission; or*
- *another option (please specify)?*

182. The Commerce Commission already has the discretion to review key inputs as a separate process for any inquiry or recommendation. The Commerce Commission has issued a number of Guidelines on application of the Commerce Act and other matters. The Commerce Commission is also presently undertaking a generic review of its approach to the calculation of WACC, which is one of the most significant inputs into any price control investigation.

183. Mighty River Power believes the matter of whether key input decisions should be set as a stand-alone process in advance of an inquiry or recommendation to regulate is an operational matter and should be left for the Commerce Commission to decide. The merits will depend on judgements about limited resources, and how they would most effectively be determined. We believe the Commerce Commission is best placed to make such judgements, and not the Government or MED.

184. If the Government decides to require key input decisions to be made in advance, Mighty River Power's preference would be for key input decisions to be set as Guidelines by the Commerce Commission. The use of Guidelines would enable the Commerce Commission the flexibility to vary from the key input decisions where this makes sense on a case-by-case basis.

185. We remind MED of the Discussion Document's regulatory design principle that *"the regulatory regime is sufficiently flexible to account for firm/industry specific circumstances, changing market conditions, innovation and experience."*⁷⁰

186. We would have very significant concerns if key input methodologies were introduced as Rules by the Minister. We reject the Discussion Document's claim that *"... Ministerial involvement may improve confidence in the decision-making process by adding additional checks and*

⁶⁹ Paragraph 42 of the Discussion Document.

⁷⁰ Bullet 4 of paragraph 23 of the Discussion Document.

*balances.*⁷¹ If the Minister set the input methodologies this would reduce the independence of the Commerce Commission. Also, the Commerce Commission is better qualified to make judgements on technical matters such as input values or methodologies than the Minister. We do not, for example, think it would be appropriate for the Minister to be making judgements as to how WACC should be calculated. Where would this stop? Decisions on the value of X in price cap regulation?

187. Mighty River Power would be concerned if the Government's role in economic regulation was extended into areas that are presently the Commerce Commission's responsibility. Such a move would heighten investment uncertainty, as it would make decisions on economic regulation much more politicised. The Commerce Commission, as technical expert, is best placed to make judgements on key input decisions such as the setting of WACC, and not the Government.

188. Mighty River Power **recommends** that the decision on whether to prescribe key inputs in advance be left to the discretion of the Commerce Commission

⁷¹ Paragraph 14 of the Discussion Document.

11 REGULATORY CONTROL DESIGN ISSUES

Chapter 9: Regulatory control design issues

1. 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?

189. The Commerce Commission should be able to use comparative benchmarking as a methodology for setting control terms. If the Commerce Act presently prevents this, for whatever reason, or there is uncertainty on the matter, then the Act should be amended such that it is clear the Commission has this ability. For the avoidance of doubt, we believe that whether the Commission uses comparative benchmarking for setting control terms should be an operational matter left to the discretion of the Commission.

190. Mighty River Power **notes** that we agree that the Commerce Act should allow the Commerce Commission to use comparative benchmarking as a methodology for setting control terms.

2. Should specific provision be made to allow the Minister to request 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?

191. The answer to the first part of the question depends on whether the Government decides to extend the economic regulation “tools” in the Commerce Act to include information disclosure and a generalised Part 4A (which may apply to services other than electricity lines). Mighty River Power does not believe it makes sense to introduce information disclosure or Part 4A on, say, a subset of natural monopolies in any sector. Benchmark comparisons are a useful feature of information disclosure, and the approach the Commerce Commission has taken to setting the Part 4A thresholds (with the exception of Transpower) has been reliant on benchmark comparisons.

192. However, the benefits of price control are discreet to the individual firms within the sector. So in terms of the existing price control provisions we do not believe any change would be desirable.

193. Mighty River Power **notes** that if the Commerce Act is amended so the Commerce Commission has a suite of economic regulation tools, including information disclosure, price control and generalised Part 4A, the changes should be made such that the Commerce Commission could choose amongst:

- a. Introducing information disclosure on all firms in the sector (which fail the competition test); and/or
- b. Introducing Part 4A on all firms in the sector (which fail the competition test) and/or
- c. Imposing price control on individual firms in the sector.

194. In respect of the second question, whether the CBA should be undertaken in a qualitative, rather than quantitative, basis, our answer is precisely the same as it was for the second question in Chapter 7. We do not believe that the Commerce Act should say anything, one way or another, about the use of quantified CBA.

195. In summary, we reiterate that this view is based on:

- a. The practical problems that would arise when the Commerce Commission needed to compare different options for economic regulations, using different tests (in this case it would be whether to regulate all businesses in a sector versus individual firms, rather than on what type of regulation should be applied);
- b. Application of quantitative CBA is desirable and reflects regulatory best practice; and
- c. The Commerce Commission already has appropriate discretion as to whether it applies a quantitative CBA.

3. Is there value in allowing firms to propose their own control terms for the Commission's consideration ('propose/respond' model)?

196. One of the amendments the Government made to the Telecommunications Act last year was the introduction of an undertakings regime, which parallels the Discussion Document's proposed 'propose/respond' model.

197. The undertakings regime provides access providers with a formal basis for avoiding regulation. They can now do so by making an access provision undertaking, but only if they do so at the start of the Commerce Commission's investigation into whether the service should be regulated.

198. Our understanding is that these provisions reflect concerns, based on past experience (with the Commerce Commission's investigations into whether to regulate Local Loop Unbundling (LLU) and fixed-to-mobile termination rates) that access providers could delay proceedings by making 11th hour offers as an alternative to regulation.

199. Analogous issues can arise in respect of the Commerce Commission's price control responsibilities (Parts 4 and 4A) under the Commerce Act. The Commerce Commission has undertaken investigations of Unison, Transpower and Vector, following breaches of the Part 4A price thresholds. In each of these cases the Commerce Commission issued a draft decision to regulate the businesses (9 September 2005, 31 January 2006⁷² and 9 August 2006, respectively). The Commerce Commission's final decisions on each of these matters have been substantially delayed due to discussions (or negotiations) with each of the parties over potential "*Administrative Settlement Agreements*", as an alternative to regulation (price control). The Commerce Commission released a draft Settlement Agreement for Unison on 9

⁷² First announced in the Commerce Commission's media release "Intention to declare control of Transpower's transmission services", Release No. 80, 22 December 2005.

November 2006, and made a final decision to accept it on 11 May 2007.⁷³ The Commission indicated its intent to agree to Settlements with Transpower and Vector last year but neither has yet been released for consultation. The Commerce Commission announced that Vector had made an Offer and that its “*preliminary view is that Vector’s offer is, in principle, consistent with the objectives of the regulatory regime*” on 13 October 2006.⁷⁴ The Commerce Commission last issued a press release, in relation to Transpower, on 4 December 2006 indicating it was in talks over a possible Settlement.⁷⁵

200. Mighty River Power **recommends** that if the Government decides to introduce a ‘propose/response’ model for the regulatory control provisions in the Commerce Act that it have regard to the undertakings regime in Schedule 3A of the Telecommunications Act 2001.

4. 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’?

201. Mighty River Power believes each regulatory control option should be subject to the same criteria for determining whether it should be introduced. The Commerce Commission should only accept a firm’s own proposed control terms if it considers that it would best give, or would be likely to best give, effect to the (proposed) purpose for Part 4/4A.

202. Obviously the merit of a requirement that the Commerce Commission automatically be required to accept proposals that meet specified criteria would depend on the detail of the specified criteria. Based on the proposed ‘reasonableness criteria’ in the Discussion Document we doubt this option would be a good idea.

203. It would be very difficult to develop a robust set of objective criteria. We have considerable misgivings about the criteria proposed in the Discussion Document, for example:

- a. The proposed criteria provides no surety that a firm’s proposed control terms would better satisfy the long-term benefit of consumers than price control than regulation.
- b. The proposed requirement for evidence that significant capital expenditure is required would mean that it could be easier for firms that have underinvested to avoid regulation. Ditto with the criteria for evidence that the necessary capital expenditure cannot be financed within the proposed price/revenue path.

⁷³ <http://www.comcom.govt.nz//IndustryRegulation/Electricity/ElectricityLinesBusinesses/TargetedControl/ContentFiles/Documents/Unison%20Decision%20Not%20to%20Declare%20Control%2011%20May%202007.pdf>

⁷⁴ Commerce Commission media release “*Vector proposes settlement and agrees to rebalance prices*”, Release No. 58, Issued 13 October 2006 at: <http://www.comcom.govt.nz//MediaCentre/MediaReleases/200607/vectorproposessettlementandagreest.aspx>

⁷⁵ Commerce Commission media release “*Transpower proposes new prices*”, Release No. 70, Issued 4 December 2006 at: <http://www.comcom.govt.nz//MediaCentre/MediaReleases/200607/transpowerproposesnewprices.aspx>

204.If the firm is able to provide evidence that the necessary capital expenditure cannot be financed within the proposed price/revenue path or that the proposed quality terms are too stringent, this evidence should be provided to the Commerce Commission as part of the Commission's consultation on the proposed form of economic regulation. If the Commission accepts the evidence as valid it can adjust the proposed economic regulation to be less stringent on the regulated firm.

205.Mighty River Power **notes** that we do not support a requirement that the Commission be required to accept proposals that meet pre-set criteria, and we consider the proposed 'reasonableness criteria' to be flawed.

5. 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)?

206.The only comment Mighty River Power has on this question is to emphasis that any such regime should be designed in a way that avoids substantial delays in final decisions on control being made.

12 POSSIBLE PACKAGES OF 'HOW TO REGULATE'

Chapter 10: Possible packages of 'how to regulate'

1. With regard to the Part 4A thresholds regime do you favour:

- *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.*

207. We do not believe that this is an either or question.

208. Mighty River Power supports:

- a. The retention of the Part 4A threshold regime under the Commerce Act; and
- b. Making Part 4A more generic so that it can be applied to other sectors; and
- c. Amending Part 5 of the Commerce Act to allow the Commerce Commission to use benchmarking to set terms and conditions for control.⁷⁶

209. Furthermore, whether or not a party supports amending Part 5 need not be related in any way to whether they support allowing firms to seek customised control terms.

210. The matter of amendment of Part 5 and customised control terms have already been dealt with in response to questions 1 and 3 in Chapter 9, and are not discussed further here. We instead limit our comments to whether or not Part 4A should be retained, and whether it should be made more generic so that it can be applied to other sectors.

211. Part 4A has only been in operation for a relatively short period of time. As of yet, the Commerce Commission has not used it to place any ELB under price control. Although the Commerce Commission has announced an intention to declare price control on Unison, Vector and Transpower; and has indicated a desire to reach Administrative Settlement Agreements with each of these ELBs. To substantially change Part 4A, including by revocation, at this stage would be entirely at odds with the Discussion Document's stated regulatory design principle of minimising regulatory uncertainty, and providing stability.⁷⁷

212. Mighty River Power considers that Part 4A of the Commerce Act has not been given sufficient time to prove itself, one way or the other. Having said that, we believe that Part 4A is beneficial and we would support it being made more generic. The Commerce Commission could then have the flexibility to recommend information disclosure, price control and/or placing a sector under Part 4A.

⁷⁶ See our response to question 1 in Chapter 9.

⁷⁷ Bullet 1 of paragraph 23 of the Discussion Document.

213. In terms of the question of whether Part 4A should be made more generic, so it can be applied to other sectors, we remind MED of the Discussion Document's regulatory design principle that *"regulatory approaches are consistent and coherent across different firms/industries and over-time"*.⁷⁸ To answer the question of whether Part 4A should be made more generic, consideration should be given to why Part 4A was established in the first place, and why all ELBs were not simply placed under price control. If Part 4A was established because of industry-specific factors unique to the electricity industry then the answer would be no. Part 4A should not be made generic. If the reasons may be applicable to other sectors then consideration should be given to making Part 4A generic.

214. It is clearly relevant that the Commerce Commission, when considering whether to recommend price control on Gas Pipeline Businesses (GPBs), expressed the view that if Part 4A was available for other industries it would have recommended it for GPBs.⁷⁹ If the Commerce Commission's analysis is accepted as valid this would lend support to making Part 4A more generic.

215. Mighty River Power believes there are a number of reasons why the Part 4A threshold regime could be seen as desirable for electricity, and potentially other sectors:

- a. There may be uncertainty around whether price control would be to the long-term benefit of end-users Part 4A would offer an intermediate option between doing nothing and full price control.
- b. If there are a large number of businesses in a sector that could be subjected to price control (as clearly there is in the electricity industry) the cost and resource requirements on the Commerce Commission, in imposing price control across the board, may mean it is not practical to do so in a robust and defensible way.
- c. Also if there are a large number of businesses in a sector that could be subjected to price control a Part 4A regime could harness this to enable 'benchmark competition'.

⁷⁸ Bullet 2 of paragraph 23 of the Discussion Document.

⁷⁹ The Commerce Commission has noted (paragraph 92 of "Gas Control Inquiry Final Report", 29 November 2004):

Control under Part V is high cost relative to other regulatory options. The Commission notes that the Minister has a wider discretion than the Commission to consider other matters including alternatives to control under Part V. The Commission considers the regulatory constraints on NGCT should be strengthened and requests the Minister consider applying to NGCT a regime comparable to the targeted control regime applicable to electricity lines businesses under Part 4A.

The Commerce Commission made the same recommendation in relation to other Gas Pipeline Businesses. In paragraph 139 the Commerce Commission went on to say:

If the Minister were to introduce alternative mechanisms for NGCT, NGCD and Wanganui Gas (such as a regime comparable to the targeted control regime applicable to electricity lines businesses under Part 4A), there may be benefits in having all businesses, including, Vector, under the same regime.

216. There are various sectors that, on the basis of the above, could be candidates for Part 4A including airports, ports, gas and the water and wastewater sectors. Industries such as telecommunications where there is only one (Telecom) or sometimes two firms (Vodafone and Telecom, e.g., fixed-to-mobile termination services) that have substantial market power/face limited competition would not be likely to be suitable for Part 4A.

2. In your opinion, are there other options for addressing the issues with the Part 4A thresholds regime?

217. Chapter 3 of the Discussion Document identified several potential issues with Part 4A of the Commerce Act:⁸⁰

- uncertainty resulting from breaching a price or quality threshold (a breach of a threshold, including technical and/or historical, *may* lead to an inquiry into whether or not control under Part 5 of Act should be imposed);
- the inability for firms to seek *ex ante* approvals for major capital expenditure (the methodology to set price and quality thresholds used by the Commission is based on sector averages and has to date been largely backward-looking⁴); and
- potentially wrong targeting (firms with a too-easy threshold are able to price up to that level while firms subject to a threshold that is too tough for their individual circumstances are most likely to breach, resulting in subsequent regulator focus potentially being on the wrong firms).

218. Mighty River Power has the following comments on these issues, and whether there are other options that should be considered for addressing them:

- a. The matter of uncertainty should dissipate over time as the Commerce Commission investigates and makes decisions on breaches of the thresholds.
- b. The inability of firms to seek *ex ante* approvals for major capital expenditure is a matter of design of the thresholds. The thresholds could have been (and could in the future) be adapted to allow revenue for major capital expenditure to be treated as “excluded revenues” if approved by the Commerce Commission or, in the case of electricity transmission, the Electricity Commission. If the Government considers that *ex ante* approval would be a desirable feature of any control regime, it should consider amending its s 26 statement on incentives of regulated businesses to invest to reflect this.⁸¹

It is notable that the Commerce Commission explicitly took into account future network investment requirements, when it considered whether to accept Unison’s Administrative Settlement Offer. The Commerce Commission noted that it “... *is mindful that – under either control or a settlement – the business in question should. On the one hand, be able to undertake a level of investment consistent with providing distribution services at a quality that reflects consumer demands and, on the other hand, be accountable for*

⁸⁰ Paragraph 49 of the Discussion Document.

⁸¹ Statement to the Commerce Commission of Economic Policy of the Government: Incentives of regulated businesses to invest in infrastructure, 7 August 2006.

*making that level of investment.*⁸² The Commission also lowered its expectation of the level of price reductions that would be appropriate under price control on the basis of evidence Unison provided to the Commission that its capital and operating expenditure projections should both increase by more than 20%.⁸³

- c. The potential to wrongly target firms is an inherent characteristic of the thresholds regime. There is a trade-off between the relative simplicity or crudity of the thresholds regime and the cost of operating price control. The simplicity of the thresholds is why a breach does not automatically result in price control, but instead may trigger an investigation. This was a matter that Unison raised in its litigation against the Commerce Commission on the thresholds regime.⁸⁴ What was clear from the High Court decision was that while the thresholds may be crude, they nevertheless place downward pressure on costs and prices overtime, and thereby met the s 57E purpose.

219. Mighty River Power does not believe that any of the issues raised about Part 4A provide justification for legislative amendments.

3. 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?

220.No.

221.Looking at this question from the perspective of the electricity industry, Mighty River Power considers there are too many ELBs in New Zealand. Substantial efficiency gains could potentially be made from further consolidation of the number of ELBs. If the regulatory control regime was designed in a way that provided small businesses with more favourable treatment this would only serve to incent them to remain small, and not consolidate.

4. Should local community owned trusts be subject to a different regulatory regime than larger non-trust electricity lines businesses?

222.Again, no.

223.We understand the theory that there may be fewer concerns about trust-owned utilities abusing their substantial market power to extract monopoly profits than privately-owned utilities. To the extent that the customers and trust-beneficiaries match-up this amounts to taking from one hand and giving with the other. The net effect (less additional taxes from the monopoly profits) would leave the community no worse off than if the utility did not earn any

⁸² Paragraph 27 of the Commerce Commission's "Reasons for Not Declaring Control Unison Networks Limited", 11 May 2007.

⁸³ Paragraph 25 of the Commerce Commission's "Reasons for Not Declaring Control Unison Networks Limited", 11 May 2007.

⁸⁴ *Unison Networks Ltd v Commerce Commission* CIV 2004 485 960, Wellington HC paragraphs 76 to 96.

monopoly profits. The Commerce Commission can take this into account in any investigation into whether economic control should be imposed.

224. Also, there will not necessarily be a match between customers and the trust-beneficiaries. Unison and Vector are examples of this. Unison's trust-area is the Hawkes Bay, while it also supplies Rotorua and Taupo. Likewise, Vector's trust-area is Auckland, while it also supplies the North Shore of Auckland and Wellington. In such circumstances, trust-ownership could create incentives to over-charge non-trust customers in order to under-charge or subsidise trust-area customers. This is one of the concerns that the Commerce Commission has raised with both Vector and Unison, and why it released draft intentions to declare control. The Commerce Commission's subsequent shift away from this intention has been based on tariff rebalancing in favour of customers outside of Vector and Unison's trust-area.

13 ACCOUNTABILITY MECHANISMS

Chapter 12: Accountability mechanisms

1. Do you consider that it is desirable to provide for merits review of regulatory decisions or does judicial review provide sufficient constraints on regulatory decisions?

225. Mighty River Power **notes** that we consider it desirable to provide for merits-based reviews of regulatory decisions, so long as suitable safeguards are put in place to prevent appellants using them to delay regulation.⁸⁵
226. Merit-based appeals would be consistent with the Discussion Document's regulatory design principle that "*there are appropriate levels of regulatory accountability and independence*".⁸⁶ The added scrutiny from such appeals should put additional pressure on the Commerce Commission to ensure that its decisions are robust, as they would face greater risks of reviews against 'bad' decisions.
227. Mighty River Power also considers that the review process should tackle the broader issue of whether other New Zealand regulatory bodies should be subject to merits review. In particular, we agree with the Cabinet Policy Committee⁸⁷ that now is an appropriate time "*to consider whether merits review should be introduced for EC decisions*".
228. The Electricity Commission like the Commerce Commission makes extremely important and complex decisions that have significant effects on property rights, the value of businesses and the economy as a whole. For example, in the case of the Electricity Commission, the HVDC link pricing decision and the 400kV North Island upgrade decision.
229. The people and businesses affected by such decisions have a strong interest in ensuring they are made correctly and according to the law. The wider community also has an interest in ensuring the standard of Electricity Commission decisions is as high as possible.
230. Mighty River Power **notes** that we consider that Electricity Commission decisions should be subject to merits review on the same basis as proposed for the Commerce Commission – appeal by way of rehearing, limits on new evidence, review limited to material issues of contention.

2. Do you agree with the document's conclusions that, if merits review is provided

⁸⁵ One of the reasons that the Telecommunications Act limits the scope for appeals is that access providers could game the regime by using appeals to delay access seekers gaining access to their access services, entering the market and competing with the access provider. The parties' incentives needs to be considered when designing appeal rights.

⁸⁶ Bullet 5 of paragraph 23 of the Discussion Document.

⁸⁷ Cabinet Policy Committee paper from the Minister of Energy "*Electricity Market Review: Improvements to current arrangements (Paper two)*" at paragraph 148.

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 is fresh and material and it could not have been submitted at the original decision-making stage?

231. Yes, with the exception of the Commission's recommendation on whether or not to impose control. Mighty River Power acknowledges the political accountabilities associated with the Minister's final decision on whether or not to impose control (naturally the Minister's decision is not appropriate for merits review). However, we consider the special significance of the Commission's decision whether to recommend control warrants the safeguard of merits review. In our view, it is critical that the Minister when deciding whether to accept a Commission recommendation can have the utmost confidence that the basis for the recommendation is sound. The added safeguard of merits review of such recommendations will only enhance regulatory certainty and decision making.

232. Mighty River Power **notes** that we agree that the scope of merits review should be limited to appeal by way of rehearing (where new evidence can only be presented if it is fresh material and could not have been presented at the stage of the original decision-making), and that the grounds of review should be limited to material issues of contention.

233. Merit-based reviews should not be allowed to be used as a vehicle for parties to fix-up failed submissions, and to try again. To allow otherwise would mean that the appellant could appeal not only on the grounds that the Commerce Commission may have made a 'bad' decision, but only on the basis that their original submissions to the Commission were deficient and could be improved on.

3. What is your preferred composition of any merits review body, taking into account New Zealand's small size and limited resources?

234. The Courts are not likely to have the necessary technical skills and expertise to review price control determinations. This is one of the perennial problems with merits-based reviews.

235. The Courts have expressed strong reluctance to review the decisions of the Commerce Commission operation of price control.

236. In *Auckland Bulk Gas Users v Commerce Commission*⁸⁸ the Court stated that:

... in a case of price control and complicated detailed accountancy matters, ... it is important that the Courts should give full regard to the decision of the Commission. It is not for this Court to overturn the Commission if it simply disagrees or thinks some other figure or figures or some other formulas might be preferred unless it appears that the Commission has gone wrong in principle or law or policy.

237. In *Welgas Holdings Ltd v Commerce Commission*⁸⁹, the Court noted that the Commission was "... palpably better placed to make decisions than an appeal Court working fairly closely to the adversarial mode."

238. In *Mercury Energy Ltd v Transpower NZ Ltd*⁹⁰ the Court noted:

⁸⁸ [1990] 1 NZLR 448 (HC), the case involved the hearing of an appeal under section 92(d) Commerce Act.

⁸⁹ [1990] 1 NZLR 484 (HC).

Whilst the Court is not unaccustomed to dealing with matters of complex economic theory, pricing methodologies and the like, and whilst it has mechanisms available to assist it in deciding those questions, it was common ground that the setting of pricing principles would be a protracted matter of considerable complexity, ill-suited to the adversarial process and one which would require to be regularly if not continuously repeated.

239. In terms of the establishment of an entity to hear appeals from the Commerce Commission and Electricity Commission, Mighty River Power **notes** that we favour a specialist tribunal loosely modeled on the Australian Competition Tribunal - a pool of judges, economists and business people, with each case being heard by one judge, one economist, and one business person.

240. What is important is that the relevant legal, economic, business and technical skills are drawn together in the appellate body.

⁹⁰ [1998] 8 TCLR 554 (HC).

14 POTENTIAL TRANSFER OF PART 4A RESPONSIBILITIES

241. A matter not mentioned in the Discussion Document, but referred to in the Government's Draft New Zealand Energy Strategy to 2050 (December 2006) is that the Government is considering whether responsibility of Part 4A of the Commerce Act should be transferred from the Commerce Commission to the Electricity Commission.

242. This matter was consulted on, in relation to transfer of responsibility in relation to Transpower, in 2005. In our submission, Mighty River Power strongly disagreed with the proposal to transfer Part 4A responsibilities for Transpower over to the Electricity Commission.⁹¹ The arguments against transfer are even stronger in relation to distribution ELBs. This is because in the case of Transpower there are significant synergies from having the same regulator responsible for Part F of the Electricity Governance Rules 2003 (which relates to grid reliability standard setting, grid upgrade approval and transmission pricing) and Part 4A.⁹² There are little in the way of equivalent synergies in relation to distribution ELBs.

243. Our reasons for not supporting a transfer of responsibility for Part 4A over to the Electricity Commission include, but are not necessarily limited to:

- a. It does not make sense to have two separate regulators responsible for 'economic regulation'⁹³ in New Zealand, particularly in a country as small as New Zealand.
- b. Having two regulators responsible for economic regulation/price control results in duplication of function and effort. This is the case for both the regulator (two regulatory bodies have to exist, and replicate each other's functions) and affected parties (who would have to go through price control processes with two regulatory bodies and litigate many issues twice).
- c. Another problem with having two regulators responsible for economic regulation/price control is that it weakens the precedent value of price control determinations. What precedent value would the Electricity Commission's approach to setting price control on Transpower or local ELBs set for industries such as airports or telecommunications? Weakening the precedent value of price control would result in greater regulatory

⁹¹ Mighty River Power "Submission on Jurisdiction under Part 4A of the Commerce Act in respect of Transpower", 19 December 2005.

⁹² These synergies could be gained from transferring Part F responsibilities to the Commerce Commission.

⁹³ Mighty River Power uses the term 'economic regulation' to encompass price control (and the related targeted thresholds regime), setting of reliability standards, approval of investments and determination of pricing methodologies.

uncertainty, which could have a negative impact on investment risks and the level of infrastructure investment.⁹⁴

- d. From a pragmatic perspective, the operation of Part 4A would be an entirely unfamiliar and foreign function for the Electricity Commission. The Electricity Commission would have to build up expertise and capability in this area from scratch. Even then the MED Discussion Paper on the matter noted the Electricity Commission “...*would be unlikely to replicate the extent of economic regulatory capability present in the CC’s staff*”.⁹⁵ This concern is exacerbated by issues around the Electricity Commission’s workload. The Electricity Commission has noted that “*The Electricity Commission has an extremely demanding workload*”.⁹⁶ Transfer of responsibilities for Part 4A to the Electricity Commission would exacerbate these workload problems.
- e. Finally, Mighty River Power considers the operation of price control should be independent of the Government. Government influence should be limited to a requirement for the regulator to “*have regard to*” rather than “*give effect to*” Government policy. Otherwise there is a potential risk that the operation of price control could be subject to political risk, which could create investment uncertainty, and reduce investment. The Commerce Commission satisfies this requirement as an independent crown entity, but the Electricity Commission does not.⁹⁷

244. Mighty River Power **recommends** that:

- a. responsibility for Part 4A of the Commerce Act 1986, and price control generally, should remain within the sole domain of the Commerce Commission;

⁹⁴ This does not mean that the regulator’s decisions are necessarily static. The Commerce Commission’s approach to “*indirect costs*” is a case in point. In the Commerce Commission’s Airports Price Control Inquiry, Gas Pipeline Price Control Inquiry and its Local Loop Unbundling Inquiry, the Commerce Commission made deductions from the benefits of regulation to take into account the indirect costs of regulation. In the Commerce Commission’s Mobile Termination Inquiry the Commerce Commission made deductions for indirect costs in its draft report. TelstraClear successfully persuaded the Commerce Commission that it should not take indirect costs into account, and this was subsequently reflected in the Commerce Commission’s final report into Mobile Termination, and its subsequent paper on its intention to place Unison under price control.

⁹⁵ Paragraph 41 of the MED discussion paper “*Jurisdiction under Part 4A of the Commerce Act in respect of Transpower*”, November 2005.

⁹⁶ Affidavit of John Charles Gleadow on behalf of the Electricity Commission in opposition to application for judicial review, 8 July 2005.

⁹⁷ The Minister of Energy has indicated (paragraph 141 of the Cabinet Policy Committee paper from the Minister of Energy “*Electricity Market Review: Improvements to current arrangements (Paper two)*”, 2006) that he considers “... *it is unrealistic and wrong to try and turn the Electricity Commission into a more autonomous body akin to the Commerce Commission.*” Accordingly, it would seem unlikely the issue would be addressed through a change in the Electricity Commission’s status.

- b. responsibility for economic regulation (e.g. Part F of the Electricity Governance Rules 2004, Telecommunications Act 2001, and Dairy Industry Restructuring Act 2001) should also be placed (or remain) within the sole jurisdiction of the Commerce Commission.

15 OTHER MATTERS

245. Any review of price control should not be limited to the provisions in the Commerce Act. The Electricity Act 1992 includes price control provisions which can be applied to ELBs and electricity retailers; namely the low fixed charge tariff provisions for domestic users. Mighty River Power considers that it is anomalous that while the price control provisions under Parts 4 and 4A of the Commerce Act both include thresholds that need to be satisfied before price control can be introduced, the Electricity Act contains no such provisions. The same situation exists under the Gas Act.

246. We consider the Part 4 thresholds (being that (i) competition is limited; and (ii) price control would be in the interests of end-users) are generally appropriate. The same or analogous tests should be included in the Electricity and Gas Acts. This is important as operation of price control in competitive (or potentially competitive) markets can inhibit competition. When, for example, Mighty River Power reviews the commercial merit of entering new parts of the New Zealand electricity retail market, we need to weigh up the additional costs (and restrictions) imposed by the low fixed charge tariff requirements.

247. Mighty River Power **recommends** that:

- a. The review of the price control provisions in the Commerce Act also encompass the Electricity and Gas Acts' price control provisions; and
- b. The low fixed charge tariff provisions in the Gas and Electricity Acts should be subject to the same purpose and tests as price control under the Commerce Act.

16 CONCLUDING REMARKS AND RECOMMENDATIONS

248. Mighty River Power is generally comfortable with where the Discussion Document gets to on amendment of the regulatory control provisions in the Commerce Act. Most of the recommendations we have made in our submission are aimed at fine-tuning the recommendations in the Discussion Document. In particular, we are supportive of:

- a. Inclusion of a generalised purpose statement, based on s 57E, that would apply to Parts 4, 4A and 5 of the Commerce Act.
- b. A focus on the long-term benefit of consumers, encompassing both efficiency and distributional considerations, through a consumer surplus test
- c. Amending the tests for regulatory control to exclude markets where competition could develop in the future.
- d. Allowing the Commerce Commission to make decisions on whether and how to regulate at the same time.
- e. Retention of Part 4A for ELBs.
- f. Inclusion of (tightly constrained) merits-based appeals.

249. We do not object to the proposals for widening the range of regulatory tools that are available to the Commerce Commission, or to a requirement for key input decisions to be made in advance of an investigation or decision to regulate. The options could add to the complexity and time involved in decision-making though. They would also add to regulatory uncertainty as it would not necessarily be known what form regulation would take.

16.1 Precedents from the Telecommunications Act

250. One of the principles the Discussion Document advocates for design of a regulatory regime is that *"regulatory uncertainty is minimised and stability and predictability of regulatory outcomes are improved over time"*.⁹⁸ Putting this principle into practice, Mighty River Power is of the view that there are various aspects of the Telecommunications Act that could be utilised in the revision of the regulated control provisions of the Commerce Act. Both the Telecommunications Act and regulated control provisions of the Commerce Act are aimed at regulating services, where competition is limited, for the long-term benefit of consumers. Aspects of approach in the Telecommunications Act Mighty River Power has identified as useful consist of:

⁹⁸ Paragraph 23 of the MED Discussion Document.

- a. The focus on long-term benefit of end-users in the purpose statement in s 18 of the Telecommunications Act. The Discussion Document already proposes this, albeit using the term “consumers” rather than “end-users”.
- b. Heightening the emphasis of efficiency in the purpose statement through s 18(2) of the Telecommunications Act. Section 18(2) could be adopted in the Commerce Act along the following lines:

In determining whether or not, or the extent to which regulated control will be for the long-term benefit of consumers in New Zealand, the efficiencies that will result, or will be likely to result, from regulated control must be considered.

- c. Use of the purpose statement to effectively set the criteria for regulation through s 19 of the Telecommunications Act, including s 19’s use of a “must” rather than “may” requirement for decision-making. Section 19 could be adopted in the Commerce Act along the following lines:

If the Commission or the Minister (as the case may be) is required under this to make a recommendation, or a decision, the Commission or the Minister must—

- (a) consider the purpose set out in section [x]; and
 - (b) make the recommendation, determination, or decision that the [Commission] or Minister considers best gives, or is likely to best give, effect to the purpose set out in section [x].
- The Telecommunications Act contains no explicit threshold on the extent or surety of the benefits of regulation exceeding the costs, beyond s 19. Nor does the Telecommunications Act contain any explicit reference to “*direct and indirect costs*”.

- e. The undertakings regime in Schedule 3A of the Telecommunications Act 2001. This is relevant to the potential approach the taken to (possible) introduction of a ‘propose/response’ model for the regulatory control provisions in the Commerce Act.

251. We have also noted that many of the issues the Commerce Commission has to address in price control investigations, and implementation of price control, are generic; not only are they applicable to price control investigations in different sectors, they are also applicable to the Commerce Commission’s approach to investigations/determinations under the Dairy Industry Restructuring Act and the Telecommunications Act. This suggests that if the Commerce Act is amended to require the Commerce Commission to make decisions in key inputs in advance of investigations/implementation of price control the requirements should also be applicable to decisions under the Dairy Industry Restructuring Act and the Telecommunications Act.

16.2 Areas of concern

252. In summary, Mighty River Power is largely supportive of the changes that the Discussion Document is advocating. The areas we have misgivings about are around:

- a. The Discussion Document considers substantive amendments to Part 4A (possible repeal) before the Part has had time to demonstrate its worth. This is not helpful in terms of ensuring regulatory certainty, though the Discussion Document comes to the conclusion that 4A should be retained (and even generalised).
- b. Mighty River Power would not like to see the role of the Minister of Energy extended to, for example, include decisions on such matters as key input decisions for regulatory control.
- c. Setting different criteria for different regulatory control options would be impractical, as the Commerce Commission would need to evaluate each of the options against each other. It could not do this with different evaluation criteria. What would happen, for example, if information disclosure satisfied the competition test, and price control satisfied the competition plus efficiency and distributional criteria? Would both be automatically introduced?
- d. Mighty River Power does not support firms being able to automatically avoid regulatory control if they met pre-specified criteria. It would be extremely difficult to develop an objective set of criteria that would be appropriate. The Discussion Document's proposed criteria have a number of shortcomings, such as that it makes it easier for firms that have underinvested to avoid control. This would be perverse and would go against the Government's policy of encouraging infrastructure investment.
- e. Mighty River Power does not support providing small ELBs and/or community trust-owned ELBs with softer regulatory provisions than other ELBs. This would create perverse incentives. There are too many small ELBs. Weaker regulatory provisions would encourage them to remain small, and not integrate (in the way that trust-owned banks consolidated). We appreciate the theoretical argument that community trust-ownership aligns the interests of consumers and the ELBs. However, this is contingent on sound governance arrangements, which cannot necessarily be presumed. It also assumes that the trust area mirrors the ELB's network area, which is not necessarily the case. Both Vector and Unison provide good illustrations of this. Key reasons for the Commerce Commission's draft decision to price control both these ELBs was concern that customers outside of the trust-area were being used to subsidise the line charges for consumers within the trust area.
- f. If merit-based reviews are allowed, then the regime should be carefully designed to mitigate the risks of gaming and delays in regulatory decision making.
- g. The low fixed charge tariff provisions in the Gas and Electricity Acts should be subject to the same purpose and tests as price control under the Commerce Act.

16.3 Recommendations

253. For the convenience of the reader, the recommendations contained in this submission are repeated below in full.

16.3.1 CHAPTER 1: INTRODUCTION

254. Mighty River Power **recommends** MED expand its list of principles for design of a regulatory regime to include:

- a. Regulatory intervention should be aimed at directly addressing durable market failures, and not just the symptoms of market failure; and
- b. A high burden of proof should be applied to regulatory intervention, i.e. regulation should only be introduced in circumstances when it is likely to result in clear benefits.

16.3.2 CHAPTER 3: POTENTIAL ISSUES WITH THE CURRENT REGULATORY REGIME

255. Mighty River Power **notes** that care needs to be taken to distinguish between concerns with the legislative specification of the regulatory control provisions in the Commerce Act, and the administration of the regulatory control provisions by the Commerce Commission.

16.3.3 CHAPTER 4: OBJECTIVES OF ECONOMIC REGULATION

256. Mighty River Power **notes** that we support the use of a consumer surplus test in the application of regulatory control.

16.3.4 CHAPTER 5: PURPOSE STATEMENT

257. Mighty River Power **recommends**:

- a. The Government introduce a purpose statement for Part 4 of the Commerce Act.
- b. The Part 4 purpose statement be applied to both Parts 4 and 4A, with the proposed Part 4 purpose displacing the existing Part 4A purpose; and
- c. The Government amend the proposed Part 4 purpose along the following lines:

The purpose of this Part is to promote the long term benefit of consumers within New Zealand by providing for regulatory control of markets where competition is limited and there is little or no prospect of competition by ensuring that suppliers with market dominance [a substantial degree of market power]:
- d. The Government add a subpart (e) to the proposed Part 4 purpose along the following lines:

(e) are able to fully recover their costs if they are operating as a reasonably efficient service provider.

16.3.5 CHAPTER 6: THE DECISION ON WHETHER TO IMPOSE REGULATION

258. Mighty River Power **recommends** that section 19 of the Telecommunications Act 2001 be adopted for Parts 4 and 4A of the Commerce Act, along the following lines:

If the Commission or the Minister (as the case may be) is required under this Part to make a recommendation, or a decision, the Commission or the Minister must—

- (a) consider the purpose set out in section [x]; and
- (b) make the recommendation, determination, or decision that the [Commission] or Minister considers best gives, or is likely to best give, effect to the purpose set out in section [x].

Mighty River Power **recommends** that if our recommendation to adopt section 19 of the Telecommunications Act is rejected:

- a. Option A be amended to read:
 - where competition is limited or there is little or no prospect of competition
- b. The competition criterion includes both options A and B.

260. Mighty River Power **recommends** that, if our previous two recommendations are not adopted, the proposed efficiency and distributional tests or criteria should be amended as follows:

Goods or services may be regulated if economic regulation is necessary or desirable to provide long term benefits for consumers in New Zealand.

or

Goods or services may be regulated if economic regulation is necessary or desirable to provide long term benefits for consumers in New Zealand.

In determining whether or not, or the extent to which regulated control will be for the long-term benefit of consumers in New Zealand, the efficiencies that will result, or will be likely to result, from regulated control must be considered.

261. Mighty River Power **notes** that we consider it unnecessary to explicitly specify a burden of proof for regulatory control in the efficiency and distributional tests and criteria.

262. Mighty River Power **recommends** that the Minister of Commerce continue to be responsible for deciding whether to introduce economic regulation, but that the Minister should only be able to introduce economic regulation following a recommendation from the Commerce Commission that the Minister do so.

263. Mighty River Power **recommends** that the Government amend the Commerce Act, as proposed in the Discussion Document, to enable the decision on whether to impose price control to be made at the same time as the decision on how to price control, rather than sequentially.

16.3.6 CHAPTER 7: TYPES OF ECONOMIC REGULATION

264. Mighty River Power **notes** that we are comfortable with the “*economic regulation*” tools in the Commerce Act being widened to not only include price control, but also information disclosure, a generic Part 4A and a negotiate/arbitrate regime.

265. Mighty River Power **recommends** that MED implement the changes to the Gas (Information Disclosure) Regulations as a matter of priority, and not allow this to be delayed by the review of the regulatory control provisions in the Commerce Act.

266. Mighty River Power **recommends** against different tests being prescribed in the Commerce Act for different forms of economic regulation.

16.3.7 CHAPTER 8: KEY INPUT DECISIONS

267. Mighty River Power **notes** that:

- a. We see value in having key input decisions, particularly on generic inputs such as WACC, made as a stand-alone process in advance of any inquiry and recommendation to regulate; and
- b. To maximise the benefit of such an approach it should apply across the Commerce Act, Dairy Industry Restructuring Act and the Telecommunications Act.

268. Mighty River Power **recommends** that the decision on whether to prescribe key inputs in advance be left to the discretion of the Commerce Commission

16.3.8 CHAPTER 9: REGULATORY CONTROL DESIGN ISSUES

269. Mighty River Power **notes** that we agree that the Commerce Act should allow the Commerce Commission to use comparative benchmarking as a methodology for setting control terms.

270. Mighty River Power **notes** that if the Commerce Act is amended so the Commerce Commission has a suite of economic regulation tools, including information disclosure, price control and generalised Part 4A, the changes should be made such that the Commerce Commission could choose amongst:

- a. Introducing information disclosure on all firms in the sector (which fail the competition test); and/or
- b. Introducing Part 4A on all firms in the sector (which fail the competition test) and/or
- c. Imposing price control on individual firms in the sector.

271. Mighty River Power **recommends** that if the Government decides to introduce a ‘propose/response’ model for the regulatory control provisions in the Commerce Act that it have regard to the undertakings regime in Schedule 3A of the Telecommunications Act 2001.

272. Mighty River Power **notes** that we do not support a requirement that the Commission be required to accept proposals that meet pre-set criteria, and we consider the proposed 'reasonableness criteria' to be flawed.

16.3.9 CHAPTER 12: ACCOUNTABILITY MECHANISMS

273. Mighty River Power **notes** that we consider that Electricity Commission decisions should be subject to merits review on the same basis as proposed for the Commerce Commission – appeal by way of rehearing, limits on new evidence, review limited to material issues of contention.

274. Mighty River Power **notes** that we agree that the scope of merits review should be limited to appeal by way of rehearing (where new evidence can only be presented if it is fresh material and could not have been presented at the stage of the original decision-making), and that the grounds of review should be limited to material issues of contention.

275. In terms of the establishment of an entity to hear appeals from the Commerce Commission and Electricity Commission, Mighty River Power **notes** that we favour a specialist tribunal loosely modeled on the Australian Competition Tribunal - a pool of judges, economists and business people, with each case being heard by one judge, one economist, and one business person.

16.3.10: POTENTIAL TRANSFER OF PART 4A RESPONSIBILITIES

276. Mighty River Power **recommends** that:

- a. responsibility for Part 4A of the Commerce Act 1986, and price control generally, should remain within the sole domain of the Commerce Commission;
- b. responsibility for economic regulation (e.g. Part F of the Electricity Governance Rules 2004, Telecommunications Act 2001, and Dairy Industry Restructuring Act 2001) should also be placed (or remain) within the sole jurisdiction of the Commerce Commission.

16.3.11: OTHER MATTERS

277. Mighty River Power **recommends** that:

- a. The review of the price control provisions in the Commerce Act also encompass the Electricity and Gas Acts' price control provisions; and
- b. The low fixed charge tariff provisions in the Gas and Electricity Acts should be subject to the same purpose and tests as price control under the Commerce Act.

Mighty River Power