

3 July, 2007

Commerce Act Review
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Commerce Act Review

The New Zealand Council for Infrastructure Development ¹ supports review of the regulatory control provisions of the Act to ensure that economic regulation in New Zealand is consistent with providing for the long-term benefit of consumers within New Zealand and considers amendments to the Act are desirable to reinforce policy objectives on investment in infrastructure.

NZCID has undertaken workshops on infrastructure development strategy amongst its member organisations and consulted widely on the issue. Workshops have included input from relevant government ministry staff, the energy sector, and NZCID member organisations.

Resulting from this process we have concluded that Part 4A the threshold regime for electricity lines is not meeting its design objectives, particularly given the absence of a mechanism for firms to seek *ex ante* approvals of significant step changes in capital expenditure; uncertainty as to the consequences of threshold breaches; and the apparent tendency to adversarial processes. We consider these issues form a disincentive for much needed infrastructural investment that is critical to meet the nation's long term infrastructure needs.

For this reason NZCID supports in general terms repeal of Part 4A and the proposal that it be replaced with the ability to put *sectors* under an amended Part 5 control regime that allows the Commerce Commission to set control terms using comparative benchmarking. We also support the option of allowing firms to propose customised control terms where they can demonstrate that the sector-wide terms are not appropriate in their case, together with the provision for merits review of control decisions made by the Commission.

¹ NZCID is a non profit organisation. Members comprise a diverse range of leading private and public organisations including infrastructure equity owners, financiers, constructors, service providers, public sector agencies, and major infrastructure users. Information on the Council, its members, policy and work can be found at www.nzcid.org.nz. In developing its policy position on infrastructure issues, NZCID consults extensively with its member organisations, undertakes workshops and seminars on policy and undertakes independent research. This submission represents the views of NZCID as a collective whole, and may not necessarily represent the views of individual member organisations, some of whom will be making their own individual submissions.

It is not clear from the consultation document how submissions from respondents are to be taken into account and whether or not an opportunity will be provided for cross submissions. The proposal does represent a significant change from the existing paradigm and potentially may have substantial cost impacts on firms affected. NZCID considers it would be helpful to have the benefit of having had the opportunity to review the submissions of others directly affected by the proposal.

NZCID recommends that following submissions on the current discussion document, a final proposed draft reform proposal and supporting implementation plan should be published in the form of a "white paper" for consideration and comment by industry stakeholders after having been able to review comment from other submitters and before it is finally committed as government policy.

This second iterative process should provide opportunity for consideration of and potentially achieve better alignment on practical implementation issues raised by industry sectors and stakeholders resulting from this first round of consultation.

The following sections of this submission address each of the specific questions raised in the consultation paper.

Yours sincerely,



Stephen Selwood
Chief Executive

Comments on specific questions raised in the consultation paper

Chapter 1: Introduction

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

The desirable characteristics of a regulatory regime outlined in Chapter 1 do not indicate any requirement the benefits of regulatory control to exceed the costs. While this is a key feature of the current process, it should be stated as a desirable characteristic of the regulatory regime. The third bullet point requires that regulatory processes be transparent, cost-effective and timely, and tailored to New Zealand's small scale in terms of resources and business size. There is no requirement for the need for the regulatory regime itself to pass a cost effectiveness test. Such a criteria should be added to the list of desirable characteristics. Appropriate assessment and review of the cost of regulation should be undertaken from time to time to ensure that the relative costs benefits are known and managed on a continuing basis.

Chapter 3: Potential issues with the current regime

1. Does the above list capture the main issues with the current regulatory regime?

Generally Yes. NZCID's primary concern with the current regulatory structure is the focus on price minimalisation, largely driven by the CPI-X price thresholds regime, potentially at the expense of long term infrastructural investment. While price reductions in the short term may be of benefit to consumers, if the pricing structure and rate of return is insufficient to enable long term infrastructural investment, customers will be the ultimate losers. We consider the regulatory regime needs more emphasis on incentivizing timely infrastructural investment. Although this issue is picked up in Chapter 4 it is not identified as a current issue in Chapter three.

2. Are these issues adequately identified and described?

See above

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

NZCID considers that the current approval processes for transmission upgrades involving Commerce Commission approval for pricing thresholds, Electricity Commission approval for transmission upgrades and RMA consents are complex, circuitous and contradictory. For example:

Local Authorities are responsible to issue consents under the RMA but are requiring increasingly higher standards of mitigation in favour of their local communities.

These processes are often inconsistent between local authority jurisdictions, time consuming, tend to favour local issues over national interests, and add significantly to cost.

Neither the Commerce Commission nor the Electricity Commission considers RMA cost drivers in significant depth within their respective approval regimes, although the Electricity Commission is required to consider sustainability issues. Rather, the statutes controlling both agencies including the CPI-X pricing threshold and the Grid Investment Test emphasise cost minimisation.

The Commerce Commission will generally not approve price increases to fund transmission investment until grid upgrades have been approved by the Electricity Commission and, even then, and price increase will be subject to CPI-X price thresholds which may or may not conform to the level of investment approved by the Electricity Commission.

The result of this circuitous “chicken and egg” approval process means that timely investments in transmission capacity may not occur or conversely, generation investment may be constrained by lack of transmission capacity and or access.

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?

Yes

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?

NZCID agrees with the recommendation that both issues need to be taken into account.

Chapter 5: Purpose statement

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

Yes. The addition of “(d) *have incentives to innovate and to invest including in replacement, upgraded and new assets and in related businesses*” is strongly supported.

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.

As per 1.1 above amend the purpose statement to include reference to the cost benefit of regulation e.g.

“The purpose of this Part is, in markets where there is little or no competition or

prospect of competition, and, where the benefits of regulation exceed the costs, to provide for economic regulation for the long term benefit of consumers of New Zealand:

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?

Yes. Preference is given to Option A where "*goods or services may be regulated if: There is little or no competition or prospect of competition in the relevant market.*"

This definition is consistent with the purpose statement and the purpose of the Act to promote competition, although determining what constitutes "little" competition is still somewhat ambiguous.

Option B refers to a substantial degree of market power. What constitutes a substantial degree of market power in this context is unclear. We note Russell McVeagh comment that there is very little New Zealand case law on how to determine whether a firm meets the threshold of "a substantial degree of market power" in s 36 (most s 36 cases have involved clear monopolies rather than borderline cases). If "substantial degree of market power" becomes the relevant threshold for regulation, it seems likely not only to add to regulatory uncertainty, but also potentially to catch a number of firms that may have a high market share but, not being natural monopolies, are highly unlikely to be subject to regulation under the existing law (except to the extent they may use their position of market power with an anti-competitive purpose).²

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?

Given the costs and complexities associated with regulation, the addition of a qualifier is warranted. "Substantially" implies some sort of quantitative substantiation whereas "clearly" implies the possibility of either a quantitative or a qualitative test. The latter is more consistent with the view that detailed quantitative assessments may be unwarranted where more light handed regulatory regime is adopted.

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)?

It should be necessary to establish that the benefits are able to be passed on. Without this requirement the regulatory control may have little value.

² <http://www.russellmcveagh.com/doclibrary/public/Competitionlaw/CompLawApr07.pdf> accessed 5 July 2007

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

It does no harm to require this given that the benefits of control must be demonstrated and the Commission would not act unless there was an identified benefit to suppliers that exceeds the cost of regulation.

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

Yes – this retains flexibility for the Minister to take into account wider policy matters and to retain the presumption that regulation is a last resort

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?

Yes – A decision to regulate requires extensive informational and technical input by the Commission, such as calculation of the costs and benefits of regulation versus no regulation. However, while being based on technical analysis, the decision often comes down to ‘policy-type’ judgments on how to make trade-offs between conflicting policy objectives. For example, regulation may be expected to limit monopoly rents and hence improve or maintain consumer welfare, but may come at a net cost to the economy. There may also be wider factors that need to be considered, such as effects on business confidence, effects on overseas investors, credibility of the overall regulatory regime and so forth. The dual approach ensures the appropriate balance between policy and technical imperatives.

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

Yes – one clearly influences the other. It is important that the decision on whether to regulate a given firm or sector is based on as complete an information set as possible, given the significant implications of a decision to regulate.

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?

Yes - this will enable proactive engagement by the parties and improved transparency about pricing decisions. It should provide the opportunity to broaden the debate beyond the current focus on short term price reductions to include evaluation of the appropriate pricing structures to cover the need for long term investment. This model allows the parties to reach mutually satisfactory trade-offs between

matters like service quality and price, security risk and cost. It places more accountability on acquirers to engage in the process and consider issues beyond just a short term reduction in cost.

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

The imposition of any regulatory control is warranted only when the benefits clearly exceed the costs. Where possible the relative cost benefits should be quantitatively assessed. However qualitative analysis may be appropriate for lighter handed types of regulation where a clear prima facie case for regulation can be demonstrated in qualitative terms. This could include substantial deviation from any agreed parameters like WACC, cost allocation, asset valuation methodology, treatment of revaluation gains and losses, treatment of taxation, depreciation etc.

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?

This proposal has merit, especially when combined with the negotiate arbitrate approach. The arbitration would need to be conducted relative to the overall result that would have occurred had these parameters been followed. The approach will allow firms and their customers to know what is acceptable and what is not well in advance and improve certainty for all concerned.

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

The reality is that some industries will be easier than others, but experience will be built up over time.

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)?

Given the inherent uncertainty surrounding the development of these parameters the use of guidelines set by the Commission following consultation with industry but subject to merits review would provide an appropriate set of checks and balances.

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?

The Commerce Commission should have the ability to either use comparative benchmarking or a customised approach, depending on which option provides the most cost-effective and efficient outcomes.

2. Should specific provision be made to allow the Minister to request at the Commission to consider whether economic regulation may be imposed on a *sector as a whole* (rather than each individual firm within a sector) and if so, should provision be made for cost benefit analysis on this matter to be undertaken in *qualitative* (rather than quantitative) terms?

Given that international experience indicates a sector approach is commonly used overseas such an model warrants application in the New Zealand context. It should be possible to benchmark key input factors in New Zealand against international norms and against comparative industry sectors within New Zealand to establish a qualitative case for light handed economic regulation. The availability of data and its application to the New Zealand context should be investigated.

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

Assuming appropriate benchmarking standards become the norm for a sector as a whole this should provide appropriate standards for comparison. Providing the option for firms to propose their own terms within 90 days of a determination by the Commission seems to provide a reasonable balance enabling firms to demonstrate the specific reasons for variance from the norm. A 90 day requirement should be sufficient time to enable this to occur given firms will be actively engaged in the process and be already well aware of the issues through their long term asset management planning processes.

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'?

It is desirable to establish pre set agreed criteria that allow flexibility around a standard to reflect issues that are specific to a firm. The proposed reasonableness criteria set out in paragraphs 170 to 173 of the discussion paper provide an appropriate set of criteria to test the validity of a firms proposed control terms. However the Commission should have the power to require firms to meet certain time or performance standards such as delivering on infrastructural investment, service standards, price reductions, environmental standards etc. for which any pricing dispensation has been allowed.

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)?

The rationale set out in section 9.3 of the discussion document is sound. The model requires a proactive stance on behalf of the business. The final control terms for a firm under investigation are crucial to the decision on whether or not to control that firm. It is unnecessary to wear the risk of the decision to control being based on incomplete information.

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.

NZCID considers the current thresholds regime is overly focused on narrow pricing benchmarks and is constraining long term investment decisions. We favour repeal of Part 4A and amending Part 5 to allow the Commerce Commission to use comparative benchmarking while allowing firms to seek customized control terms.

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

Replacing 4a under the proposed option 2 is supported on the basis that it encourages input by the industry and should stimulate industry best practice models being developed over time. It also ensures long term investment drivers are balanced against pricing regimes and requires this to be demonstrated in an open and transparent manner.

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?

Small businesses in a sector should not be significantly affected provided their long term planning meets acceptable industry norms, which should be the case. Those on the margin may see benefit in improving economies of scale.

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

No, for the reasons set out in paragraph 197 of the discussion document.

Chapter 11: Processes for amending and enforcing control terms

1. Do you agree that control terms should not be re-opened within a specified control period, other than under exceptional circumstances? If so, do you agree with the exceptional circumstances suggested in this Chapter?

The emphasis of the approach should be to “do it once and do it right”, thereby providing certainty for investor confidence. Given the extensive opportunity for resolution of issues provided under the proposed under option two, and the opportunity for merits review, there should not be a need to re-open control terms within a specified control period, other than under exceptional circumstances.

2. Are the current provisions relating to penalties in the Act for breaches of control terms (s70C) satisfactory or should additional guidance be provided?

The provision of additional guidance will improve certainty for firms. There should be opportunity for input on this as part of the control terms development process and firms should have the opportunity of merits review of penalties.

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?

Merits' review is supported noting that this is consistent with the New Zealand Legislative Advisory Committee recommendations that appeal rights are desirable subject to certain cost and delay constraints.

2. Do you agree with the document's conclusions that, if merits review is provided for, it should only apply to control decisions made by the Commission and be limited to the form of 'appeals by way of re-hearing' where new evidence can be introduced only if it is fresh and material and it could not have been submitted at the original decision-making stage?

This provides a useful balance between the need to provide for review and the cost and delay that review processes may entail. We note that the Legislation Advisory Committee Guidelines 13.4.1 recommend that appeals should usually be by way of rehearing, and this is the approach that has been adopted for Commerce Commission decisions on mergers and acquisitions and trade practices, which most commentators consider has worked well to date. This minimises costs

compared with appeals *de novo*, and ensures that firms put all relevant material before the Commission. However it does enable updating material to be placed before the appeal body, which can be important where for example discretion is re-exercised because of an error at first instance. We consider that appeals on regulatory issues should be by way of rehearing. Tactical delays could also be addressed by ensuring that a merits review does not of itself prevent the regulator's decision coming into effect, i.e. the regulator's decision would stand unless overturned by the appeal body.

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

This is an issue that should be guided by input from the legal profession.

Chapter 13: Next steps

1. Submitters are requested to provide specific, quantitative information on costs and benefits wherever possible to assist the Ministry in undertaking any cost benefit analysis.

This is an issue individual firms will be able to provide input on.