



Tauranga Chamber of Commerce

Submission to the Ministry for Economic Development on Review of Regulatory Control Provisions under the Commerce Act 1986 Discussion Document

July 2007

About the Chamber

The role of the Chamber of Commerce Tauranga Inc. is to promote business vitality in the greater Western Bay of Plenty region. Our mission is to provide leadership and services to the business community that drive business growth and prosperity, and to make our community and region the best place to live, work, play and visit through effective and relevant advocacy, networking, education and leadership.

The Tauranga Chamber of Commerce is a membership based organisation with membership comprising 850 businesses. Endorsement of the Chamber's local 'voice of business' role is indicated by a 16% growth in Chamber membership over the year to December 2006. The Chamber has a wide reach into the business community crossing the full range of demographics in both business size and activity. Our reach extends beyond business owners to the thousands of employees who work in these businesses. We also have a growing number of member organisations providing community services, and whose interests we strive to represent. We are the largest regional Chamber outside the four major hubs.

We have a significant interest in regional economic development and a direct role in administering central government programmes for fostering business development and growth. The Chamber supports and encourages new business establishment, provides information and services to the business community, offers training and networking opportunities to Chamber of Commerce members and to the greater business community.

As part of the Smart Business Group, in partnership with agencies like New Zealand Trade and Enterprise, Priority One, Export NZ BOP, and the Sustainable Business Network, we actively seek to work cooperatively to benefit businesses in the Bay of Plenty and through them the wider economy. The Chamber is a key stakeholder in our major regional strategies: SmartGrowth and SmartEconomy and been an active participant in key activities and projects contained within, which are important to ensure our City is in the best possible position to cope with the challenges of the future.

Introduction

The Western Bay of Plenty sub-region is experiencing strong population growth which is expected to continue.

- The current population is 147,100.
- The region has experienced a growth rate of 12.9% from 2001 to 2006, and projections are for the population to reach 198,000 by 2021 and 284,000 by 2051.
- This growth rate is approx twice the national average.
- By 2013, Tauranga will be New Zealand's 4th largest city (counting Auckland as one city).
- GDP for the sub region is expected to grow above the national rate, averaging 2.5% pa over the next 50 years.
- Total employment is projected to increase by 70% by 2051.
- The development at Papamoa East will house 40,000 people.

In this high growth environment it is essential that investment in electricity infrastructure not only keeps pace with sub-regional demand, but also that existing deficiencies in the network are addressed.

To ensure that this growth is planned and managed, the Councils in the region have partnered with community agencies, to form SmartGrowth – a long term growth management strategy targeted at ensuring infrastructure is built ahead of demand, and that growth is managed in a sustainable way. Smart Growth has planning horizons of 20 and 50 years. A priority area in the strategy is to ensure sufficient capacity and security of electricity supply for the sub-region.

A recent workshop of representatives from the four local councils, the Smart Growth chairman, Priority One (a key economic development agency in the Western Bay of Plenty), Powerco and Transpower was held to discuss security of power supply for the sub and full region. Representatives from a number of generator/retailers also attended. Feedback from this workshop was that the regulatory regimes imposed on the transmission and distribution companies provide a disincentive to investment, which means that investment to address growth and reliability issues may be sub optimal.

Priority One have submitted to you regarding the importance of a secure electricity system to the local economy, and the need to look beyond simple control of monopoly behaviour, to establishing a regime which incentivises continuous performance improvement, and optimises the economic value to the community. We support their submission – the key points of which are outlined below.

Key Points

Significance of a Secure Electricity Supply

A modern economy has a very high dependence on a secure power supply. With the advent of electronic data processing and communications, most companies cease to operate during a power outage. There is thus a strong trade off between the cost of provision of electricity supply, and the economic value to the consumer.

Unlike other services, electricity is supplied in real time. It cannot be stored, and alternative forms of supply are generally cost prohibitive, except for mission critical activities, where some companies install standby generators. Customers have negligible ability to switch to other services in the event of a disruption.

The costs of a power outage can be substantial. Not only do companies lose production and revenue when they cannot produce, but they are also exposed to additional costs in paying for unproductive staff in anticipation of the power supply being restored. In the Western Bay of Plenty we have a number of companies employing large numbers of people in semi rural areas. Fault tracing and network repairs in these areas can take long periods, resulting in heavy costs to industrial consumers.

Transmission and distribution costs make up a relatively small component of a consumers power bill, yet the transmission and distribution providers have the greatest impact on security of supply. Rarely does a generation fault result in an outage to the consumer. There is anecdotal evidence that consumers would be prepared to pay more, for increased reliability.

The focus on restraining network providers' profits has the potential to result in sub-optimal performance, with cost impacts to the community in excess of the value of the price/profit under control. In setting any regulatory intervention, a balance must be achieved between the impact on the provider and the impact on the local economy.

Focus of Commerce Act

The primary focus of the Commerce Act is to maintain and promote competition. In the case of monopoly businesses, the predominant regulatory mechanism is to impose sanctions restricting the achievement of superprofits by monopoly businesses.

While there is nothing fundamentally wrong with this approach, it has a drawback in that the focus is on restraining the monopoly provider, rather than looking at the net benefit or otherwise to the overall economy.

From a consumer perspective, concerns over security of supply, as measured by power outages, and investment to address growth, prevail over the issue of price for the service.

There have been examples overseas where overly heavy handed regulation has led to the collapse of electrical infrastructure, imposing an economic burden on the community vastly greater than the value gained from the regulation. This

demonstrates the asymmetrical risk profiles between the service provider and the community serviced.

It is important in reviewing the electricity sector regulatory regime, to take a community economic view, rather than simply address profits earned by service providers.

Criteria for Regulation

The discussion paper proposes a test for when regulation may be imposed. The proposed test comprises:

“economic regulation is necessary or desirable to

- *Provide efficiencies in a market*
- *Provide long term benefits to persons acquiring the goods and services that exceed the direct and indirect costs of regulation.”*

We support this proposal as it moves the analysis beyond simply looking at the costs to the service provider, and introduces a balance of requiring a review of whether there is benefit to the consumer. This should address the issue of price vs performance.

Threshold Regime

The discussion paper identifies that the threshold regime does not target optimal performance, and may result in the regulator focussing on the wrong firms. The threshold regime has no impact on companies who are able to operate within the established thresholds.

Similarly there is a lack of consistency in actions taken in the event of a breach. This creates an environment of uncertainty, which restricts companies' willingness to invest and impedes service providers from directly addressing the needs of the community. What is needed is a regime which incentivises continuous performance improvement, for all service providers, with the regulator able to focus on clear performance breaches.

As an example, the current Powerco SAIDI threshold is set at the average of the previous 5 years performance. Even with modest performance improvements, there is a high probability (close to 50%) that they will breach this performance threshold. The consequence is an expensive and time consuming investigation, yet we understand that where companies have made similar breaches, none have resulted in regulatory controls being imposed. This approach does not incentivise performance improvement, and there is no data to demonstrate whether this results in a “soft” or “hard” target, or indeed whether a breach warrants intervention by the regulator.

We support the abolition of the thresholds regime and suggest the use of a commercial negotiation regime, which would discover the appetite of consumers for trade offs between price and service delivery. Benchmarking against other providers would inform those negotiations.

CPI-X

CPI-X is a recognised device to force continuing downward pressure on prices. It is particularly relevant to large stable organisations with a high potential for productivity improvement – e.g. high labour content businesses. We understand that CPI-X is a threshold established by the Commerce Commission and not a direct requirement of the Commerce Act. It is however relevant to investment in the electricity industry and deserves comment.

The recent regional electricity forum indicated that the CPI-X regime had the potential to inhibit investment to address growth or system reliability issues. In particular, CPI-X is not appropriate for capital intensive industries with long investment cycles (where there is little ability to achieve cost reductions between investments) and where new asset costs have recently incurred substantial price increases. Examples given were recent step changes in international prices for electrical copper for conductors, and for high quality magnetic steels for transformers.

Our comments under thresholds apply to the CPI-X regime.

Purpose Statement

The current purpose statement (s 57E), focuses on limiting monopoly company profits. The discussion document proposes including a statement to have incentives to innovate and invest. We support this proposal.

While this goes some way to address the need to incentivise investment, there is an additional requirement to balance the costs/prices of the electricity network provider against the broader economic interest of the community served. For example, a relatively minor imposition of prices/profits may limit investment and impose substantial economic impacts on the community.

Alternative Risk/Reward regimes for electricity transmission and distribution companies.

The current regulatory regime is based on first establishing a breach, before interventions are made. The process for establishing acceptable performance, and therefore setting the limits at which a breach is identified are not robust. There is potential for companies to take advantage of “soft” thresholds, while the regulator may inappropriately target companies with “hard” thresholds.

What is needed is a regime which provides ongoing incentives for continuous performance improvement. Such models exist in private sector relationship contracts such as developing alliances or partnering. In essence a power distribution company is in partnership with the community it serves, and a partnering approach is a legitimate solution.

A typical model for this style of contract is for open book direct flow through of costs, with returns to shareholders being linked to achievement of performance criteria. Elements of the incentive regime profit linked KPI's could include:

- Network reliability improvement
- Cost reductions to consumer
- Public and employee safety
- Comparative benchmarking

While this concept is possibly outside the scope of a review of the Commerce Act, it potentially provides an environment where the interests of the monopoly provider and the community served are aligned, and where incentives are in place to reward behaviour which is in the interests of the community. Under this type of regime, the need for regulatory intervention would be much reduced.

Repeal of Part 4A

We have previously discussed shortcomings with the thresholds system, which is the focus of part 4A.

We support the establishment of a regime based on comparative benchmarking, but which enables individual companies to develop individual proposals for consideration by the Commission. This regime would enable an appropriate balance to be achieved between competing issues of price, system performance, investment, return to the investor, and economic benefit to the community.

Summary of Submission Points

We support the following

- Development of a purpose statement which provides incentives to innovate and invest for improved performance.
- Inclusion of a requirement in the purpose statement for regulations to consider efficiency and performance improvement as well as consumer price protection.
- Inclusion of a requirement in the purpose statement for interventions to be balanced against the greater community economic performance.
- Removal of the thresholds regime, in favour of a commercial negotiation system, backed by benchmarking against other providers.
- Removal of the CPI-X regime in favour of a regime which balances investment against the needs of the community, and which allows the service provider a reasonable rate of return on that investment.
- Establishment of a benchmarking regime which would enable the public to readily identify relative performance of their local electricity network provider.

- Repeal of section 4A and establishment of a comparative benchmarking regime.