



MAJOR ELECTRICITY USERS' GROUP

8 May 2014

Steven Bailey
Inquiry Director
Regulatory Institutions & Practices Inquiry
New Zealand Productivity Commission

By email to info@productivity.govt.nz

Dear Steven

Regulatory institutions and practices

1. The Major Electricity Users' Group (MEUG) welcomes the opportunity to comment on the NZ Productivity Commission's "Regulatory institutions and practices, draft report", March 2014¹. This submission has been considered by MEUG members and is not confidential.
2. The draft report is a very useful reference for theories of and practical problems experienced in the ongoing challenge to design and implement effective regulatory regimes. The brief comments that follow provide some insights on our experiences with the areas we are most familiar with in working with regulators governing the electricity sector, ie the Commerce Commission, the Electricity Authority and the Energy Efficiency and Conservation Authority (EECA).
3. **Effective engagement, discussed in Chapter 8**, is an ongoing topic of discussion with all of our regulators. There is an openness and willingness to find improved methods of engagement. The main challenge is how to communicate and therefore have effective dialogue and feedback on often complex technical, economic, legal and commercial issues with all classes of electricity users'.
4. Discussion papers written in "regulatory-speak" may not resonate with affected consumers. Regulators should make an effort to describe and quantify impacts on different consumers. A reluctance to describe those effects because regulators are interested in economic welfare enhancing outcomes not re-distribution of economic surpluses between producers and consumers can be short-sighted. Controversial regulatory changes that have material winners and losers are prone to politicisation as discussed in the next paragraph. To improve discovery of all relevant information and therefore promote better decisions, MEUG suggests regulators be up front about the effects on different parties and therefore have an informed rather than a politicised debate.

¹ Document URL <http://www.productivity.govt.nz/sites/default/files/regulatory-institutions-and-practices-draft-report.pdf>
found at <http://www.productivity.govt.nz/inquiry-content/1788?stage=3>

5. If issues become highly politicised some parties may deliberately spread misinformation. It's a delicate balance for regulators to assess when to step in to provide evidence to refute such misinformation and when not to. MEUG has no solution as to what might be best practice and a principled rule to apply in such cases. It may be a question the Commission could consider.
6. **Chapter 10, decision review**, is relevant to MEUG because of our current appeal to the Court of Appeal on the High Court decision on the merit review of cost of capital Input Methodology. Lodging an appeal was not a trivial exercise for MEUG. A major factor was and remains the issue of exposure to Court awarded costs should the appeal not succeed. We believe exposure to court costs is a significant barrier in general to consumers in accessing, on an equal footing to the much better resourced monopolies, appeal processes. Court hearings without a counterbalancing view of consumers to the arguments by the monopolies may not discover all the relevant evidence to make sound decisions. In improving appeal processes policy makers need to consider barriers, such as exposure to court costs, for consumer engagement.
7. MEUG agrees with the 8 recommendations in **Chapter 13 Funding regulators**. The Commerce Commission and Electricity Authority have, in our view, conducted comprehensive and transparent consultations on levies affecting electricity consumers. Those processes have been continuously improving and we hope that will continue to ensure work programmes are targeted at highest value outcomes.
8. Our engagement with EECA on the electricity efficiency levy has not been a success for a number of reasons as discussed later in paragraph 11 a).
9. **Chapter 15 System-wide regulatory review** has four recommendations on how the stock of regulation is managed. MEUG supports these recommendations. Chapter 8, effective engagement, and chapter 10, decision review, cover development of new regulations and how parties can address major actual/perceived incorrect regulatory decisions. In our experience there is also a raft of legacy regulatory decisions that have poor outcomes that should be, but are not, re-examined.
10. The reasons for continuing poor regulation to remain in place include the high cost to affected parties to make a challenge, uncertainty of how to proceed with a challenge and uncertainty of outcome. Sometimes there is institutional inertia within the regulator and excuses that there is always other higher priority work to get on with. Poor decisions can be artefacts of initial poor Ministerial decisions that officials perceive as politically "too hot" to expose to critical examination. Other regulations can become obsolete because other factors in the sector and regulatory framework have changed.
11. We accept there is a cost to reviewing past decisions. There is also a cost in terms of confidence by affected parties in a regulators impartiality and future decision making ability when prior contentious decisions remain "on the books" with no clear path to improve outcomes. Poor prior regulatory decisions can also result in additional regulatory patches being required to manage unforeseen detriments. Poor regulatory decisions can also be used as a precedent for further poor decisions by proponents arguing that because policies and regulations are currently "on the books" they must be valid and therefore an extension of those policies is also valid.

12. Two examples of prior poor regulatory decisions to illustrate these points follow:

- a) Part of EECA's funding is by way of a \$13m per year electricity efficiency levy on all power users' proportional to their annual electricity demand. MEUG has been a consistent opponent of this levy². In summary members of MEUG already have strong incentives to use electricity efficiently and therefore the levies MEUG members pay, approximately 25% of the \$13m, is a cross-subsidy to other classes of consumer. In addition we do not believe EECA have evidence that application of levy funds has made a material difference to electricity efficiency in the economy as a whole compared to the case had EECA programmes funded by the levy not been implemented. The initial decision to establish this levy was politically motivated rather than based on a robust analysis of possible market failures and consideration of possible solutions, including funding options, to overcome material proven failures. The submission of Business NZ referred to on page 321 of the Commission's draft report provides collaborating evidence back grounding the establishment of the EECA electricity efficiency levy.

An independent and comprehensive review of the rationale for and effectiveness of the EECA electricity levy is needed. The risk is that if this levy stays "on the books" then EECA or other parties will use this precedent for similar energy efficiency levies to apply to transport fuels, gas and other energy forms.

- b) The Electricity Industry Act 2010, amongst other things, established the Electricity Authority to replace the Electricity Commission. Section 42 of the Act titled "Specific new matters in Code" set out six items the Electricity Authority had to include in the new electricity industry code otherwise the Minister retained the power for three years from the code commencing to amend the code for those matters. Many of those matters were non-controversial. Other matters were and remain in dispute as to whether they improve competition, reliability and efficiency.

One example that we have questioned is the so called "stress test" quarterly requirements for certain market participants. Compliance with the stress test requirements is almost in the category of "noise" though it is frustrating that we can see no value in having to comply with the requirement. This policy and other policies decreed in section 42 should be subject to independent and comprehensive ex post reviews. For the stress test regime the reasons used to justify the intervention have, in our view, become obsolete as the structure of the industry has radically changed, new risk management products have become available and liquidity of trades increased, plus observed behaviour of participants under recent extreme dry-period conditions have demonstrated markedly improved sophistication to manage such risk compared to prior events.

Yours sincerely



Ralph Matthes
Executive Director

² The last MEUG submission to EECA on the levy was 22nd October 2013, document URL <http://www.meug.co.nz/includes/download.aspx?ID=130989> found at <http://www.meug.co.nz/Site/submissions.aspx>