

11 May 2018

Nick Russ  
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Electricity Authority  
By email to [TelcoFibre@comcom.govt.nz](mailto:TelcoFibre@comcom.govt.nz)

Dear Nick

### **Fibre implementation funding**

1. This is a submission by the Major Electricity Users' Group (MEUG) on the funding discussion paper 'Implementation of the New Regulatory Framework for Fibre Services' 30 April 2018.<sup>1</sup>
2. MEUG members have been consulted in the preparation of this submission. This submission is not confidential. Some members may make separate submissions.

### **Consumer participation in implementing the new fibre monopoly regulatory regime**

3. Chapter 3 of the paper considers the potential to include additional funding for consumer representative groups. Two questions are asked of stakeholders:
  - Would it add value to the fibre implementation process to allow funding for consumer representative groups to engage with our consultation processes?
  - Which would provide better value input into our implementation process – an expert panel representing consumers, or a group comprising of non-expert community representatives?
4. The paper states:<sup>2</sup>

“We have not undertaken any design but, based on other regulators' experience and our relative scale, we consider it likely that such a regime could be implemented for under \$1m, over the three years.”
5. MEUG is interested in precedents for interventions to facilitate consumer participation for regulating fibre that might flow onto the energy sector. The following sections consider:
  - a) Achieving an optimal level of consumer participation is complex;
  - b) Defining consumers and estimating benefits;
  - c) Identifying policy problems and feasible solutions; and
  - d) The benefits of interventions must exceed costs, accountability and who pays.

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<sup>1</sup> URL <http://www.comcom.govt.nz/dmsdocument/16239> at <http://www.comcom.govt.nz/regulated-industries/telecommunications/industry-levy-and-service-obligations/implementation-of-the-new-regulatory-framework-for-telecommunications-funding-discussion-paper/>

<sup>2</sup> Funding discussion paper paragraph 64.

### **Achieving an optimal level of consumer participation is complex**

6. MEUG supports the Commission raising the question of if and how consumer participation might be facilitated in implementing the new regulatory regime for monopoly fibre services.
7. This is a complex topic we have been grappling with for many years. As recently as last December we discussed this topic in MEUG's briefing to incoming Ministers:<sup>3</sup>

“It is too hard for consumers to participate in the regulatory processes governing the electricity sector and MEUG would urge Ministers to ask officials and regulators to consider ways to remove barriers to consumer participation.

The complexity of issues and information prevents most customers understanding let alone effectively participating in regulatory processes. Regulators have made improvements in simplifying issues, for example explaining decisions in terms of impact on an average household. However, too often we continue to encounter the attitude that the issues are complex and cannot be explained in simple, accessible terms. That is unacceptable.”

8. The first paragraph of the MEUG briefing to Ministers essentially said we think consumer participation is a problem but we haven't, despite watching various models overseas, yet found a solution that might work for New Zealand. MEUG wants Ministers, officials and regulators to also worry about this problem. The more people that have this topic on their radar the better chance new solutions might be developed where benefits clearly exceed costs. Hence, we welcome the Commission's paper recognising this should be a topic to consider from the outset of the new fibre regulatory regime.
9. The second paragraph of the MEUG briefing covered one barrier to consumer participation; namely regulators not communicating the impact of proposed or final decisions in lay-terms relevant to an average household consumer (though we noted this has been improving in recent years). The question of identifying barriers to consumer participation is discussed from paragraph 16 onwards. Before that we discuss the complexity and importance of defining consumers.

### **Defining consumers and estimating benefits**

10. The purpose statement of Part 4 of the Commerce Act begins “The purpose of this Part is to promote the long-term benefit of consumers in markets ...”<sup>4</sup> Consumers of regulated services need to be distinguished from customers of entities providing regulated services. A customer of an entity that supplies regulated services can be an end consumer of the service or an intermediary such as wholesalers, retailers or aggregator which pass on the service as part of a service bundled with other services. An end consumer either:
  - a) Consumes the service such as in the electricity sector a household or a supermarket consuming electricity to provide heating, cooling, driving electric motors etc.
  - b) Transforms the regulated service into another product and service where the regulated service cannot practically be unbundled. For example, in the electricity sector industrial manufacturers consume electricity in motors, heating and cooling processes to produce commodities (eg aluminium, steel, pulp, paper, packaging, milk products, refined petroleum products, gold, glass, fertiliser and beer) that are then sold for consumption in other markets other than electricity,

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<sup>3</sup> MEUG letter to Hon Dr Megan Woods, Minister of Energy & Resources, and Hon Kris Faafoi, Minister of Commerce and Consumer Affairs, Briefing by MEUG, December 2017, <http://www.meug.co.nz/node/899>

<sup>4</sup> Commerce Act 1986, s.52A (1), <http://www.legislation.govt.nz/act/public/1986/0005/latest/DLM87623.html>

11. It is important to consider which parties are consumers rather than customers in a regulated sector. In some cases, the intermediary customers of a market have in part or whole incentives to promote the long-term benefit of consumers. Electricity retailers have strong incentives to maintain a high degree of vigilance and provide expert views on boundary issues between regulated and non-regulated services but less so, at least in a consistent co-ordinated and sustained fashion, on other regulatory parameters. MEUG's incentives in representing commercial and industrial (C&I) consumers are more aligned across all the Part 4 issues that affect household consumers. Our impression is that in the regulated airfield services market the incentives on the Board of Airline Representatives of NZ (BARNZ) is also well aligned with the consumers of those services. For the fibre sector we suggest a stock-take is needed of the roles and incentives of fibre customers (intermediaries and their trade-associations) to identify topics where there is or will be a voice aligned with the interests of consumers and where there are gaps.
12. The purpose statement of Part 4 talks about "long-term benefits" to consumers. The next two paragraphs discuss price effects as one part of the price-quality pairing that "long-term benefits" refer to. We don't discuss quality further other than to note quality and price should be considered as a pairing, with a lower price coupled with lower quality and higher prices with higher quality. In the electricity sector we have barely scratched the surface on incorporating quality-price trade-offs for different classes of consumer and this will become more relevant and complex with disruptions in technology and business models. The same may apply in the fibre sector.
13. Regulators in the electricity sector have, for major consultations and decisions, progressively included estimates of the impact on prices for an average household. The diversity of household energy demand patterns due to many factors makes impacts for an "average household" less relevant for many consumers.<sup>5</sup> The impacts of regulatory decisions on commercial and industrial (C&I) consumers are rarely estimated. A further complicating factor is wholesaler, retailer or aggregator intermediaries may re-bundle regulated prices making Commission estimates of reported average household price benefit/cost changes incorrect. Over time competition should drive re-bundling closer to straight pass-through changes. Assurances to consumers price benefits/costs will transition over the long-term are of less interest as to what are the immediate effects and having greater clarity on the whether the expected transition period is reasonable.
14. MEUG expects in the fibre sector estimating the impact on the price of regulated services of regulatory options and decisions for an average household may have the same problem where that measure is not relevant for a reasonable number of non-average households and C&I consumers and or is re-bundled by most intermediaries. If true, the same problem we find in the electricity sector may occur where few consumers except those clearly affected because their demand is so large take close interest in regulatory design.
15. Finally, having a more accurate estimate of the impact on disaggregated consumer segments is no guarantee consumers will then increase the level of their participation in regulatory matters because the impacts may be small relative to other issues.

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<sup>5</sup> Factors include housing stock differences (eg levels of insulation and floor area per occupant), occupant differences (eg number and age of occupants and frequency and timing at home), and use of alternative energy sources (eg reticulated natural gas in the North Island, LPG, solid fuels including use of wet-backs for heating water, solar hot water, PV and batteries).

## Identifying policy problems and feasible solutions

16. Before interventions are considered, the Treasury cost-benefit-analysis guidelines require identification of the policy problem to be solved. Once the policy problem has been defined (usually in terms of the market failure to be addressed, in this case the market for effective consumer participation in the implementation of the fibre market regulatory regime) then policy options can be considered. The funding paper in seeking feedback on possible solutions skips the important stage of defining the policy problem.
17. In this section we discuss some, not necessarily all, policy problems and alternative solutions that could be considered in addition to those discussed in the funding paper.
18. In the MEUG briefing to incoming Ministers (paragraph 7 above) the policy problem we discussed was the failure of regulators to explain their decisions in terms understandable and relevant to an average household. As discussed in the preceding section, the next phase for the Commission in the electricity sector is to expand estimates of the price impact on customers from a grand-average-household to more disaggregated estimates for discrete classes of consumer, pairing price impacts with quality impacts and considering if re-bundling materially distorts price estimates. We expect there will be ongoing improvements in all these aspects by the Commission; though it won't be a quick fix.<sup>6</sup> The same may apply to the fibre sector.
19. The policy problems of access by consumers and understanding the relevance of decisions given only grand-average-household price or cost effects are part of a wider problem of information and resource asymmetry between the regulated party and customers or their retailers and agents that contract directly with the monopoly. We assume, though it's not specifically stated in the funding paper, that the suggestion of consumer representative groups is targeted at the policy problem of information and resource asymmetry.
20. From MEUG's monitoring of international experience with consumer representative groups in the electricity sector there are risks such groups are captured by consultants or special interest groups and or used for political window dressing. The latter is discussed in the final paragraph of this section. If these risks materialise then all or some consumers end up being as disenfranchised from the consumer representative group as they are with the monopoly supplier and regulator; but must pay for the consumer representative group anyway.
21. The one exception of a consumer expert panel that we think has been useful was the expert peer-review panel in the original Input Methodology (IM) process in 2010. That expert group had an incentive in maintaining their independence and expertise to provide free-and-frank feedback to the Commission. The three changes we would make were a similar expert panel be used again are:
  - In considering the make-up of the panel the Commission could consult consumer representatives beforehand in case there were potential material conflicts of interest the Commission was unaware of or other candidate experts that could be considered;
  - The role of the expert panel is to represent the interest of consumers guided by the s.52 (A) Purpose statement. That is the panel is not neutral as that is the role of the Commission. But the panel is also not given an advocacy role outside the objectives of the s.52 (A) Purpose statement; and

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<sup>6</sup> An aspect to consider in the electricity sector is whether the incentive on the Commission to articulate more granular price-quality effects on different consumer classes is weaker because the Commission is only responsible for regulating aggregate price/revenue and quality metrics of an entity providing regulated services.

- The expert panellists hold a workshop with consumers to discuss their findings before they are presented to the Commission. This creates an incentive on the experts in formulating their views to:
    - Communicate those in terms understandable to a broad range of consumers; and
    - Reconcile their views between two audiences: The Commission and consumers.
22. Even if consumers or agents for consumers (intermediaries with aligned incentives or an expert peer-review panel) become well-informed and provide supporting or new evidence to the Commission, there remains a problem of resource asymmetry in the ability of parties to undertake merit reviews of Commission decisions.<sup>7</sup> The monopolies not only have deep pockets but can also seek provision for court costs to be included as part of a price or revenue path and hence be recovered from consumers.
  23. In the electricity sector MEUG has undertaken merit reviews but we are not aware of any other consumer or other party with incentives aligned with consumers, apart from BARNZ, which have initiated merit reviews. We have no data but speculate that regulated monopolies have spent more than an order of magnitude more than MEUG and BARNZ on merit reviews. A consumer representative group without an ability to follow through with a merit review, or that group has no individual representatives that could do so, illustrates that such groups might address some consumer participation policy problems but not all.
  24. An interesting thought experiment is whether electricity consumers would have preferred to have spent \$1m over 3-years for a consumer representative group or to fund a merit review of the WACC asset beta Input Methodology decision in 2016. If MEUG members were paying part of a \$1m levy (we argue against that later in paragraph 31), our vote would probably have gone on a merit review.
  25. There is a risk that a consumer representative group allows the Commission to test and or be a conduit for preparing customers for proposed decisions. This overcomes a policy problem the Commission may have in managing the political stability of its decisions. MEUG is wary of using a customer representative group in this manner unless that is its clear stated purpose and the Commission, as the initial direct beneficiary, absorbs that cost rather than pass it on as a levy to customers (ie the cost is recovered from general taxation).

**The benefits of interventions must exceed costs, accountability and who pays**

26. Conceptually the optimal level of resources used by end consumers in development of the new fibre regulatory regime should be no more than the incremental benefits gained by the deployment of such resources. In practice estimating incremental benefits and incremental costs of alternative interventions is challenging.
27. One issue to consider is that the future business-as-usual (BAU) counterfactual is likely to differ from the status quo as continuous improvements are implemented. That is there are likely organic improvements by the Commission and consumers in how they interact. That will be facilitated by a greater range of social media and technologies to reach different classes of consumer and more disaggregated data to estimate changes in prices and quality for different consumer classes.

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<sup>7</sup> While the text of this discussion only mentions merit reviews; the same logic applies to barriers to consumers initiating judicial reviews of Commission regulatory decisions.

28. In the case of implementing the new regulatory regime for monopoly fibre services, estimating costs would cover the \$1m over 3-years for Commission direct costs and it is likely a reasonable range of scenarios for fibre market participant and customer direct costs could be estimated. The funding paper has no estimates of the offsetting benefits to justify the Commission's direct costs of \$1m and we think that is a non-trivial exercise. Before decisions are made to intervene an estimate of the incremental benefits should be made and tested with interested parties. In some cases, MEUG has been sufficiently confident, despite a lack of precise quantitative evidence, that a proposed regulatory change is likely to have incremental benefits well in excess of the incremental costs of change, the net-benefits are likely to be greater than any other alternative and there are no feasible scenarios where net-benefits might be negative. We are not confident this applies to the proposed solutions posed in the questions in the funding papers (paragraph 3 above).
29. If the Commission decides to budget for an intervention(s) as suggested in the funding paper then mechanisms to require an ex-post review or reviews of the effectiveness of the intervention should be considered. Having this accountability loop will incentivise the Commission to prudently design the intervention and ensure that any future use of similar approaches is effective as possible.
30. An intervention by the Commission of up to \$1m over 3-years to facilitate consumer participation in the implementation of the new fibre regulation will need to be paid by somebody. Options include (not an exhaustive list) from general taxation, from the fibre monopolies (they would pass the cost on) and from consumers benefiting from the intervention. Subject to further details emerging of any proposed intervention, MEUG's preference is that beneficiaries pay. Only after a detailed cost-benefit-analysis identifies if all consumers equally benefit or some more than others can a levy structure be set using an appropriate cost allocator.
31. An example of the latter using the electricity sector follows. MEUG members through MEUG membership subscriptions and work programmes already participate extensively in development and operation of the Part 4 regime regulating energy monopolies. To that extent MEUG members have self-selected to pay their own way in participating in Commission processes and would pay less, if anything, than other consumers for Commission interventions to facilitate consumer participation.

#### **Next steps**

32. MEUG welcomes the Commission including a discussion on consumer participation at the outset of thinking about implementing the new fibre regulatory regime. We acknowledge the Commission is not just talking about this but, as explained at the workshop, is actively encouraging feedback through a dedicated "fibre in-box". This submission does not directly answer the 2-questions on consumer participation in the funding paper. Instead we have given some initial comments on aspects of the topic that could be considered using our experience in the electricity sector. We would welcome an opportunity to meet with the Commission to further explore the topics in this submission.

Yours sincerely



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