Submission

by

Business NZ

to the

Commerce Select Committee

on the

Electricity and Gas Industries Bill

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1. INTRODUCTION

1.1 Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce and the Otago-Southland Employers' Association), Business NZ is New Zealand's largest business advocacy body. Together with its 53-member Affiliated Industries Group (AIG) which comprises most of New Zealand's national industry associations, Business NZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

1.2 In addition to advocacy on behalf of enterprise, Business NZ contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

1.3 Business NZ's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services).

1.4 It is widely acknowledged that consistent, sustainable growth well in excess of 4% per year would be required to achieve this goal in the medium term.

1.5 The health of the economy also determines the ability of a nation to deliver on the social and environmental outcomes desired by all. First class social services and a clean and healthy environment are possible only in prosperous, first world economies.

1.6 Business NZ believes both a secure and stable delivered electricity supply and investor confidence in accessing the associated generation fuels to be critical elements in achieving the OECD ranking goal and to that end we have made a number of submissions on energy matters to committees of the House and departmental officials. In addition, we have been represented on the taskforces established in both 2001 and 2003 to address the severe supply situations that arose in the winters of those years and are currently a member of the Gas Industry Steering Group.

1.7 The Electricity and Gas Industries Bill ("the Bill") is intended to give effect to Government policy decisions on electricity supply security and on governance of both the electricity and gas industries. While Business NZ acknowledges that aspects of the proposed legislation are a direct consequence of the <u>electricity</u> industry's failure to agree to a self-governance regime and its failure to address issues highlighted by the crises of 2001, resulting in a repeat in 2003, we do have serious concerns in a number of areas.

1.8 These include:

- the extensive regulatory powers encompassed in this piece of legislation;

- the multiplicity of roles proposed for the Electricity Commission

- the apparent intent to impose a regulatory regime on the gas industry and;

- the compliance costs implicit in the proposed new regime and the consequent added costs the demand side, or consumers, will inevitably face, notably those associated with the reserve generation concept.

2 EXTENT OF REGULATION

2.1 This Bill is characterised by a strong bias toward a comprehensive regulatory approach. There are some areas where the small size of the market and potential regional market domination is a demonstrable risk and it may be a degree of selective regulation is appropriate. It is, however, critical to note that while the New Zealand market is small the generation and infrastructural investment requirements to adequately service that market are large, have considerable lead times and involve significant sunk costs. An overly regulatory approach by Government presents a very real risk that investment in this vital area will be jeopardised.

2.2 Section 172D of the Bill identifies 53 areas of the market where it is proposed the Minister may introduce regulation. Business NZ submits this is excessive and unnecessary. Many of the areas proposed for regulation are currently in existence and working relatively effectively.

2.3 Section 172D (1), for example, addresses wholesale electricity market issues and includes reference to pricing and quantity, clearing, settling and reconciling transactions, and scheduling and dispatch. These wholesale market activities are currently operational, work under a set of market rules with measures in place to address transgressions. A return to a centrally directed, regulatory approach in reference to the pricing and dispatch of electricity can only be viewed as a negative step.

2.4 There are, however, other areas where participants in the wholesale market, notably on the supply side, have been resistant to change. Disclosure of market information, including hedge and contract volumes and prices, offer a particular example. Regulation is also proposed in this area, but Business NZ would submit that encouraging an inclusive rules-based approach would be less intrusive than a direct regulatory approach. It is worth noting that for sometime now aggregated information regarding contracts and prices has been freely available on the Comit web-site. It could be argued that regulating for more detailed hedge, contract and price disclosure between sellers and buyers of electricity would present an unacceptable breach of commercial confidentiality.

2.5 Business NZ’s concerns over the blanket regulatory approach epitomised by Section 172D can be summarised by referring to comments Dr Graham Scott has made to the Committee in a submission endorsed by Business NZ:

"The assumption of total government control over the details of the operations of many parts of the industry does offer the possibility of implementing through regulation well-designed, and probably already known, solutions that have been held up in the past due to alignments of interests in the industry that run against the wider public interest. On the other hand, the Bill entrenches a move from a world of dynamically changing voluntary agreements among market participants albeit in an imperfect market, to one of regulated solutions based on technical and political judgement. Industry participants will be incentivised to spend greater resources on political lobbying as a means of securing their commercial interests. Those less inclined to do so initially will, over time, be forced to do so as well in order to protect their interests from the lobbying efforts of others.

Before long the legacy of voluntary agreements will recede into the past and outcomes will emerge from complex games within and between the regulators and the regulated and the Minister. Eventually the process will become self-referential as it will become impossible to assess interventions against counterfactual outcomes. In short it will be difficult to assess whether individual decisions were the right ones because there will be nothing with which to compare them. Yet the impact of decisions are likely to be substantial and long lasting."[1]

3 THE ROLES OF THE ELECTRICITY COMMISION

3.1 Along with its role in recommending and implementing regulation the Electricity Commission is also to contract market operations, purchase reserve generation capacity, sell that capacity in times of constrained supply, promote energy efficiency and manage emergency conservation campaigns, develop and approve complaints resolution systems, be an arbitrator of fines and penalties, act as an industry facilitator, be the decision maker and approver of pricing and service provision functions of distribution (lines) companies and Transpower, and provide policy advise to the Minister.

3.2 In addition, the Electricity Commission has the potential under the current proposals to take over the functions of the Commerce Commission in relation to the electricity industry. This will effectively mean the Electricity Commission, who will be engaging in commercial activities, will be regulating itself. Business NZ also notes that the Explanatory Note to the Bill advises (p19) that the Electricity Commission is to be exempt from the restrictive trade practice provisions of the Commerce Act 1986.

3.3 Business NZ submits that this proposed multiplicity of roles, particularly in reference to regulatory power, policy advice and engagement in commercial operations, violates all accepted good public sector management practices, will result in a serious lack of transparency and a very weak accountability framework. No matter how well managed, as proposed the Electricity

[1] "Submission on Electricity and Gas Industries Bill", Dr Graham Scott, LECG Economics Finance, Section 3

Commission will be a market participant and this will inevitably lead to a loss of the independence essential to a market regulation role. The proposals currently embodied in the Bill for the functions and powers of the Electricity Commission will not result in achieving the desired policy objective of ensuring, *"that electricity is delivered in an efficient, fair, reliable and environmentally sustainable manner to all classes of consumers"*, nor will they result in the stability and certainty that is urgently required if the country is to achieve the desired sustainable pattern of economic growth.

4 REGULATION OF THE GAS INDUSTRY

4.1 The proposals in the Bill involving the gas industry effectively mirror those for the electricity industry and, if implemented, would see even further Government intrusion into the energy sector in that the Electricity Commission would become the Energy Commission.

4.2 Business NZ notes that the comments in the Explanatory Note (pp19-20) regarding the gas industry, and in particular the role of the Gas Industry Steering Group (GISG), are excessively negative and in some respects erroneous. Business New Zealand wishes to advise the Committee that, contrary to statements in the Explanatory Note, the GISG has made significant progress. A proposal outlining a co-regulatory model that would avoid the costs and unnecessary regulation implicit in this Bill has been developed and conveyed to the Minister.

4.3 Given the broad consensus that is emerging within and between both the supply side and demand side of the industry Business NZ submits to the Committee that the proposed provisions in the Bill providing for reserve regulation provisions for the gas sector be deleted.

5 COMPLIANCE and CONSUMER COSTS

5.1 The extensive regulatory regime proposed will inevitably bring increased compliance costs to the electricity industry, and potentially the gas industry. These will arise directly in the form of levies to fund the Electricity Commission's activities and fees and charges relating to service provisions and market operations, and indirectly in the form of costs involved in the increased lobbying and advocacy activity the proposed new regime invites. It is also quite probable that as a result of the confused and multiple roles of the Electricity Commission poor performance will result and an excessively litigious environment emerge.

5.2 The reserve generation activity initiated by the Minister and now to be legislated for in the provisions of this Bill also brings significant added cost. Business NZ, and a number of other organisations, opposed the reserve generation concept when it was originally mooted. Given it has now been implemented we see little point in restating our argument other than to note our strong opposition to the use of what is effectively retrospective legislation.

5.3 The cost areas identified above will all impact on the consumers of electricity and gas. There is no reason whatsoever to believe the suggestion in the Explanatory Note (p23) that the costs of compliance will rest with "all industry participants and major users of electricity", or that, "they would not be significantly greater than compliance costs under any feasible alternative governance structure". It is normal commercial practice for additional costs accrued with the production of a commodity to be reclaimed at the point of sale. The end electricity or gas consumer, and thus the economy, will therefore carry the not inconsiderable cost of the proposed new regime.

5.4 Business New Zealand submits that the Committee does not support the passage of the Bill at this time and the Committee request a full evaluation of the costs implicit in the new regime be furnished by officials.

6 CONCLUSION and RECOMMENDATIONS

6.1 The regulatory powers proposed by this piece of legislation are excessive and, as noted above, in a number of areas appear to have little justification. Regulation is proposed for market activities where few, if any, problems have been observed. The gas industry is functioning effectively yet the Bill proposes blanket regulation. It would appear that the designers of this regulatory regime have paid scant attention to the measured direction found in the "Guidelines on Process and Content of Legislation" prepared by the Legislation Advisory Committee[2]. Those guidelines note that there are a number of options that need to be considered in seeking to address an identified problem and achieving a particular policy objective including:

- no government intervention;
- status quo;
- use of existing law;
- increasing enforcement;
- information and education campaigns;
- economic instruments (taxes, subsidies, and tradable property rights);
- voluntary standards/codes of practice;
- self regulation; and
- co-regulation.

The self-governance efforts of the electricity industry did fail, but it is unlikely positive outcomes will be achieved by interpreting that failure as a demonstration that a comprehensive, and convoluted, regulatory regime is the only possible alternative. The measures implicit in the Bill will result in investment uncertainty, bring unnecessary added costs to all participants, including consumers, and will foster an atmosphere of debate and litigation. They will not bring security and stability of supply.

[2] www.justice.govt.nz/lac/

6.2 Business NZ recommends to the Committee:

- the blanket regulatory regime, particularly that delineated in section 172D, be carefully examined with a view to introducing less intrusive measures where deemed necessary;

- the role and function of the Electricity Commission be changed to remove all potential conflicts and any commercial functions be specifically constrained;

- the reserve regulation provisions for the gas sector be removed; and

- the Committee does not further advance the Bill until officials have provided a full evaluation of the costs implicit in the proposed measures.

Business NZ wishes to be heard by the Committee in support of this submission.