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Dear Laurie

Proposed Levy Arrangements for the New Electricity Governance Regime

Business New Zealand is pleased to have the opportunity to provide a submission to the Ministry of Economic Development on its consultation document entitled 'Proposed Levy Arrangements for the New Electricity Governance Regime', dated June 2010.[1]

Introduction

Business New Zealand welcomes the Ministry of Economic Development's early moves to consult on the impact of the changes, as set out in the Electricity Industry Bill currently before the House, on the make-up of the levy and how it is to be allocated.

Fundamentally, the main functions currently being delivered are continuing to be delivered (albeit by different organisations), so the proposed new levy design as summarised in Table 2 on page 14 of the consultation document appears to be broadly appropriate. However, having said that, BusinessNZ has some specific comments it wishes to make on a few matters. These relate to the exclusive focus on the mechanistic aspects of who should pay for what element of costs, rather than some more strategic issues, and the fact that the Ministry for Economic Development has, in some cases proposed a novel view of who the beneficiary of the expenditure is (and therefore who should pay).

[1] Background information on Business New Zealand is attached in Appendix One.

Specific Comments

While in general agreement with the new proposed levy arrangements, BusinessNZ has the following comments on two specific areas, these being:

1. the mechanical rather than strategic focus of the consultation paper. In its singular focus on determining the parties on which the levy requirement is to fall, the Ministry of Economic Development has missed an opportunity to raise some more strategic levy-related issues; and

2. the basis on which the Ministry of Economic Development has assessed to whom some of the levy costs should be allocated, and whether that is appropriate.

BusinessNZ comments on each of these, in turn, briefly below.

A Mechanical not Strategic Focus

BusinessNZ recognises that the primary purpose of the consultation document is to outline who is to pay for what. However, in focusing exclusively on the mechanistic aspect of who should pay for what element of costs, BusinessNZ considers that the Ministry of Economic Development missed an opportunity to at least raise some issues of a more strategic nature. For example, these relate to:

1. the missed opportunity to signal, with the recent inclusion of stationary energy, industrial processes and liquid fossil fuels in the emissions trading scheme, the need for a broader conversation around the use to which the electricity efficiency portion of the levy might be put. BusinessNZ does not consider that the commencement of such a conversation about the most appropriate use of the levy to be inconsistent with the purpose of the consultation paper. The consultation paper states that:

   > " ……. the purpose of this paper is to consult on allocation of levy costs between activities and industry participants."[2]

   In BusinessNZ's view, given the new context of the emissions trading scheme, a conversation about the purpose of the funding is a necessary prerequisite to one about who should pay and it is insufficient to simply assume the status quo (regarding either purpose or allocation). BusinessNZ considers that a strategic conversation of this nature should have been led by the Ministry of Economic Development, if only to ensure that the subsequent consultation required under section 127 of the Electricity Industry Bill is not simply about the level of funding.

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[2] Ministry of Economic Development consultation paper entitled 'Proposed Levy Arrangements for the New Electricity Governance Regime', dated June 2010, page 7.

In the absence of the Ministry of Economic Development commencing such a conversation, BusinessNZ considers that the future focus of the funding be aimed at carbon efficiency and not just electricity efficiency. In being so focused, it should assist businesses address the barriers that relate to how businesses can better understand and mitigate carbon emissions as well as the barriers that impede the uptake of low emissions technologies and processes. This is likely to have implications for the allocation of costs; and

2. setting the scene for how the agencies (the Energy Efficiency and Conservation Authority [EECA], the Electricity Authority [EA] and the Ministry of Economic Development) who will spend the levy should go about fulfilling their obligations under section 127 (Consultation about request for appropriation). The consultation paper separates out consideration of who should pay from any consideration of how those who pay will be able to determine whether value for money is being delivered. BusinessNZ considers this separation to be both undesirable and a missed opportunity.

   Despite well known expectations on consultation, the extent of information previously provided by the Electricity Commission in its consultations on its appropriations was grossly inadequate. BusinessNZ would hope not to see such malpractice being followed by EECA or the EA. The quality of the information provided by the Electricity Commission often gave the impression of an agency going through the motions rather consulting in a meaningful way. The dearth of information generally meant that stakeholders (and those who ultimately paid – end consumers) were generally unable to draw any linkages between such basic elements as budget, spend to date, forecast out-turn and the following year's proposed spend. Views on the trade-offs between quality and quantity were also unable to be made.

   BusinessNZ considers that the consultation paper provided the Ministry of Economic Development with the opportunity to think more broadly as to the "*method* of calculating or ascertaining the amount of the levy" (section 226(5)(a) of the Bill) to set out some minimum 'markers' or expectations regarding the nature (for example, the obligation to consult be fulfilled in a way consistent with the principles set out in the Wellington Airport case) and form (such as the basic elements set out above) of the consultation to be undertaken under section 127. More specifically with respect to form, BusinessNZ notes that the Treasury Guidelines includes the following guidance as to information standards:

   > "8.2 Output standards and levels
   >
   > *Identify how the levels and standards of an output are determined, whether by user demand, or by the public-sector provider. If it is the provider who determines them, what role do users play?*
   >
   > The provider needs to give users confidence that the levels and standards of an output are not simply determined by internal

requirements, but do take adequate account of user needs. T his is particularly important when users are paying.[3]

and

“The consultation process should genuinely strive for feedback on costs and charges, and on service standards and levels.”

and

“Users should have ready access to actual and prospective cost data and a say in setting standards and output levels.”[4]

At a minimum, BusinessNZ would expect to see such standards outlined in the regulations.

The Basis on Which some of the Costs have been Allocated

Paragraph 40 of the Ministry of Economic Development’s consultation paper notes the two principles that have been used to guide the development of the proposed changes to the levy allocation amongst industry participants. These are existing allocations where the function is being transferred and:

“For all other functions, levy costs should be allocated, as best as possible, to the beneficiaries of the function.”[5]

The Ministry for Economic Development reaches, without much effort, a set of conclusions ostensively based upon its assessment of who the beneficiaries are. However, Business New Zealand does not believe that some of the cases are so clear cut.

The Treasury’s Guidelines note that:

“ …….. neither ‘beneficiary pays’ nor ‘risk exacerbator pays’ are necessarily efficient as charging rules. They are simply used here to identify charging options.”[6]

The key part of the Treasury Guidelines - before reaching conclusions about the best charging option - is that it’s first necessary to determine the nature of the output being delivered and whether it has the characteristics of a public, club, private, or merit good. In BusinessNZ’s view, this analysis has implications for two of the proposed allocations, these being:

1. the EIRA exemptions: It is unclear why the assessment of applications for exemptions from the restrictions retained from the Electricity Industry Reform Act (currently fulfilled by the Commerce Commission) is now proposed to be provided for under the levy. This reassessment

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[3] Treasury Guidelines for Setting Charges in the Public Sector (December 2002), page 23.

[4] Op cit, page 24.

[5] Ministry of Economic Development consultation paper, ibid, page 11.

[6] Treasury Guidelines, ibid, page 12.

implies that the nature of the good has somehow shifted from being 'private' to 'merit' good. The fact that there is expected to be fewer applications does not appear to be sufficient grounds on which to decide not to introduce fee regulations at this time. Consistent with the Treasury Guidelines (referenced by the consultation paper), the benefit of such an application is <u>entirely</u> private, and therefore as the beneficiary (the applicant) can be identified, they should continue to pay. If, as expected, the costs *are* expected to be small, then it would be as appropriate (using the Ministry of Economic Development's own logic) for the EA to bear the costs in the first instance without recourse to levies and for the EA to seek fee regulations to be made at a future date should the number of applications and/or the cost of applications become substantial. This would at least place the incentives in the right place; and

2. written requests by the Minister: it is unclear why the logic of beneficiary pays applies in some instances but not others. The beneficiary of these reviews can clearly be identified – the Minister – and there is no expectation that the outcome of the reviews is that the electricity market will change as a result of them. Other than process matters, the only obligation set out in the Bill is that they be made publicly available (section 20(5)). Market participants should only pay for these reviews if clear evidence can be presented that they are in fact the beneficiaries of them. This is, in BusinessNZ's view, unlikely to be easy to do except in the most generic of ways. BusinessNZ also wonders whether the legislative authority to charge market participants for such reviews exists.

   As the benefits of these reviews are likely to be public in nature, and be used to inform policy development, BusinessNZ proposes that this be funded by the Ministry of Economic Development from within its existing appropriation with no recourse to levy funding. Should the Ministry of Economic Development not accept this proposal, the costs of this power to request should be listed as a separate activity and recorded separately for reasons of accountability and transparency.

Finally, BusinessNZ queries the analysis with regard to the allocation of the costs associated with the supply and demand scenarios. BusinessNZ agrees with the Ministry of Economic Development that the costs of this function are likely to be relatively small, so that the administrative costs created by collecting levy funding for this purpose may outweigh the benefits. However, in light of this, it is hard to follow the conclusion which immediately follows this statement which says that:

> "It is proposed that any costs to be recovered through the levy continue to be allocated to the Transmission Operations function."[7]

[7] Ministry of Economic Development consultation paper, ibid, page 17.

The low likelihood of the work undertaken by the Ministry for Economic Development assisting investment planning by industry participants (in fact, realistically no investor is likely to rely on this output in anything other than a tangential sense), and the extremely small marginal additional cost of this new work given that Ministry for Economic Development already undertakes energy forecasts (as recognised by the Ministry of Economic Development), combined with the costs likely to be incurred by the obligation placed on the Ministry of Economic Development to consult (as set out in section 127 of the Bill) strongly suggest to BusinessNZ that this be funded by the Ministry of Economic Development from within its existing appropriation with no recourse to levy funding.

Summary

Given the statutory authority to collect and allocate levies, Business New Zealand considers that the Ministry of Economic Development faces a high burden of proof to assure stakeholders that the statutory right has not been taken for granted. Questions such as who should pay the levy are fundamental to this.

BusinessNZ considers that on the most part, the consultation paper to have adopted a thoughtful and methodical approach to working through the issues thrown up by the new Bill. However, in some instances, BusinessNZ has queried why the Ministry of Economic Development has either not asked the prior question of why' before mechanistically moving to address 'who', or not attempted a more critical assessment of some of its conclusions. BusinessNZ has reached different conclusions where it has done so and it urges the Ministry of Economic Development to reconsider its proposals in light of BusinessNZ's analysis.

Yours sincerely

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Business New Zealand

APPENDIX ONE: ABOUT BUSINESSNZ

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 New Zealand is New Zealand's largest business advocacy body. Together with its 54 strong Major Companies Group, and the 70-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, BusinessNZ 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.

In addition to advocacy on behalf of enterprise, BusinessNZ 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.

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