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Dear Carl

Three Foundational Consultation Papers

BusinessNZ is pleased to have the opportunity to provide a combined submission to the Electricity Authority on its suite of consultation papers entitled 'Interpretation of the Authority's Statutory Objective', 'Consultation Charter' and 'Charter About Advisory Groups', all dated 8 November dated July 2010.¹

Introduction

BusinessNZ welcomes the release of these consultation papers so quickly after the establishment of the Electricity Authority. Collectively these papers define how the Electricity Authority will 'point' at its stakeholders and in doing signal to consumers and investors alike the approach that it will take.

The approach is sound. BusinessNZ sees the three foundational documents as signalling a welcome return to a more measured public policy-orientated discussion as to how to improve competition and maintain an acceptable level of security of supply. In being so framed, it is clear that the Electricity Authority has wasted no time in casting-off the practices of its disestablished predecessor to define itself a clear path. In doing so, BusinessNZ takes some considerable heart from such following statements:

"As amendments to the Code can substantially affect industry participants, and unpredictable and ill-founded amendments can undermine investor confidence, the Authority considers there is value in stating principles that the Authority and its advisory groups must

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

adhere to when considering Code development matters. The primary purpose of the principles is to provide industry participants with greater predictability about decision-making in likely amendments to the Code, to maximise investor certainty”²

We hope that the day-to-day reality of the Electricity Authority reflect BusinessNZ’s optimism in practice.

Given the interconnectedness of the issues addressed in the three consultation papers, BusinessNZ has incorporated its relatively minor responses to them into this letter. However, the issues raised by each paper are addressed under the headings of each of the consultation papers.

Interpretation of the Authority’s Statutory Objective

BusinessNZ welcomes the Electricity Authority’s interpretation of its statutory objective as an orthodox statement of applied economics. The orthodoxy of the interpretation is aided by the wealth of supporting interpretative information, from the Commerce Commission and the economics literature. The interpretation is particularly welcome given the previous benchmark of the highly subjective elements of its predecessor’s statutory objectives.

Regulatory stability is critical to a well functioning market. Over the past decade, the market has swung from one extreme (being the NZEM arrangement which largely excluded meaningful input from consumers) to the other of 'regulate first and ask questions later'. All classes of investors, on both the demand and supply sides of the industry need to be assured that their investments will not be expropriated by regulatory opportunism.

With the Electricity Authority’s interpretation, it is expected that businesses will now have a clear and orthodox public policy framework within which the operation of the Electricity Authority, in particular the incremental changes that it makes to the Code, can be assessed. However, BusinessNZ does have some suggestions which it considers will further clarify and/or enhance the Electricity Authority’s interpretation of its statutory objective. These are:

- while it is appreciated as likely to be implicit in various statements in the paper, BusinessNZ considers that it would be highly desirable to include in its interpretation of the competition limb of its objective *explicit* reference to the incentives to provide services at a quality that reflects consumer demands. Similarly, consistent with the discussion about productive efficiency, it would also be useful to capture the idea of sharing the benefits of efficiency gains with consumers in its interpretation;
- BusinessNZ welcomes the recognition, in paragraph A.31, of the potential cost of regulatory uncertainty when determining minimum total

² Electricity Authority consultation paper entitled 'Consultation Charter', dated 8 November, 2010, page 15, paragraph 2.2.

costs of securing reliable supply for the long term benefits of consumers as it is too easy to forget that ultimately these costs are borne by consumers;

- paragraph A.38 fails to capture the intent of its lead-in sentence, instead appearing to sound like an ex-post rationalisation of the Electricity Authority's predecessor's decision to procure M-co's market software. The waste of private (as opposed to public) resources does not give rise to a regulatory concern that requires regulatory intervention (i.e. there doesn't immediately appear to be a market failure that the procurement of software is fixing) and the example ignores the innovation benefits that lie in private ownership. A better example would be one of government failure where the costs of the solution exceed the costs of the problem being fixed;
- the intent of paragraph A.47 is unclear. It is unquestionably the duty of the Electricity Authority to act within the confines of the law. This includes acting within the scope of its powers under the Act and within the confines of its objective statement. However, in the context of acting in the long-term benefit of consumers, it is unclear what the sentence that states:

“The Authority does not believe it has the authority to adopt counteracting measures even when it believes more efficient operation of the electricity industry could be achieved by doing so.”

is intended to mean. Perhaps the addition of “where those measures address issues outside the powers of the Electricity Authority” after the words “counteracting measures” would help in clarifying its meaning. Alternatively, BusinessNZ notes that paragraph 2.2.3 of the consultation charter paper notes that the first principle to which the Electricity Authority will adhere is lawfulness – that is, that changes to the code are lawful and are consistent with the Electricity Authority's statutory objective. These or similar words could be helpful in the context of paragraph A.47; and

- finally, it is worthwhile noting that the expression “long-term” is important because it is generally interpreted by the Courts to rule out short-term benefits to consumers through wealth transfers that ultimately damage long-term welfare, for example, by discouraging investment.

The Consultation Charter

While on the face of it this consultation paper is simply about fulfilling a functional (albeit statutory) requirement, it continues to pick up on the themes introduced in the context of the interpretation of the Electricity Authority's statutory objective, being certainty, stability and transparency. These are welcome themes which, if applied rigorously, can contribute to improving outcomes for both consumers and investors.

In this context, BusinessNZ has the following comments it wishes to make with respect to the detail of the consultation paper:

- in order to better reflect the purpose of the principles set out in paragraph 2.2.3, BusinessNZ considers that the lead-in to the list of principles (along with consequential edits) should read “The Authority and its Advisory groups will only consider amendments to the Code that are:
 1. Principle 1 - Lawful: amendments to the Code must be lawful and consistent with the Authority’s statutory objective.
 2. Principle 2 – Identify Efficiency Gains or Market or Regulatory Failure.....and so on;
- in order to ensure that the distinction between public and private benefits and the role of Government to enhance public and not private benefits, the first bullet point of Principle 2 should be amended to read:

“it can be demonstrated that enhancements to the Code will deliver a net public benefit”;
- prohibitive transaction costs (while admittedly sounding bad) are a potential source of inefficiency but not a form of market failure (externalities, asymmetric information, public goods and abuse of market power being the traditionally recognised forms of market failure). BusinessNZ suggests that reference to such costs be deleted from the second bullet point of Principle 2;
- it would be useful to state the obvious in Principle 3 – that in relying upon the use of a quantitative assessment, benefits should outweigh costs and between alternative options (with equal effectiveness), the cheapest one should be chosen or, in the case of options with the same costs, the one that has the best outcome should be adopted. These leads on neatly into the ‘tie-breakers’ and the first ‘tie-breaker’ is where there is no clear best outcome, and ‘tie-breaker’ 2 concerns where the benefits do not clearly outweigh the costs;
- BusinessNZ cannot discern a material difference between Principles 7 and 8. The possible presence of public goods (i.e. goods and services that are non-rival and non-excludable) has been addressed in principle 2 (as the presence of a public good can often be a cause of market failure), and principles 7 and 8 both essentially address the question of *how* the problem should be addressed as it is generally accepted that the presence of public goods generally require more rather than less onerous forms of intervention. Therefore BusinessNZ considers that Principle 7 can be deleted;

- while on the one hand suggesting that a principle be deleted, BusinessNZ proposes the addition of a new principle on the other hand. The new principle relates to the '*option value of waiting*' and is considered to fit comfortably under 'tie-breaker' 2 (indeed, to a certain extent it could be considered to be implicit in Principle 9 but BusinessNZ considers it warrants being stated separately). Regulators face the unavoidable fact that they operate in a world of uncertainty. Moreover, an incorrect decision by regulators may potentially impose very large costs on firms and the economy. Such costs occur through distorted resource use and reduced investment and innovation (that is, they impair allocative and dynamic efficiency). Reduced investment results in a compounding loss of value that may become quite substantial over a long period. If initial policy responses are inadequate, the original intervention can be intensified or additional measures can be deployed. Where interventions cause market changes that are uncertain but irreversible, policy design should set a higher cost benefit threshold. Holding off intervention until there is this higher level of benefit is often referred to as recognising the 'option value of waiting' in making irreversible interventions;
- in explaining the rationale for each principle, the Electricity Authority sets extremely high expectations for all market participants when proposing Code amendments where, in paragraph 2.2.5 it says:

“In providing such explanations, these proponents are expected to support their qualitative analysis with quantitative analysis where this is feasible.”

The Electricity Authority needs to be careful not to preclude consideration of amendment proposals because the initial standard of proof is set too high. While the submission of proposed Code amendments need to meet certain requirements, it is inappropriate to expect submitters to replicate the Electricity Authority's own requirements. In particular, in setting this high expectation, it appears that little thought has been given to the stringency of these requirements for membership-driven organisations like BusinessNZ, or NGOs. In this context, “feasibility” is expected to accommodate a degree of understanding by the Electricity Authority regarding the resources available to such groups in making their proposed amendment. BusinessNZ notes that paragraph 4.11 (Part 1 of the Draft Consultation Charter) states that:

“The Authority will process all proposals for Code amendments in accordance with the provisions of the Act, and the Authority's policies.”

For natural justice reasons, it is important that the quality of the initial submission not implicitly preclude erstwhile good ideas;

- the Electricity Authority poses the question as to whether the principles should also apply to market facilitation measures. The consultation paper notes that such principles should not immediately apply to the development of such measures as they are voluntary. However, BusinessNZ's experience under the Electricity Commission was that more often than not when combined with monitoring and benchmarking, 'voluntary' tended not to mean voluntary at all but rather a stepping stone or explicit threat to making the measure mandatory. Therefore, BusinessNZ suggests that *all* proposed interventions, voluntary or otherwise should be assessed against the same principles unless it is clear that their voluntary use does not bring with it the implicit threat of future mandatory requirements;
- paragraphs 3.1.9 and 3.1.10 outlines the Electricity Authority's broad approach to those circumstances where it doesn't have a statutory obligation to consult (such as in the case of papers that are analytical precursors to consultations on the proposed amendments to the Code, for example issues and options papers). However, consistent with the Electricity Authority's desire to enhance the contribution of stakeholders in its processes and to secure a greater degree of buy-in from stakeholders, BusinessNZ suggests that while it is right that the Electricity Authority does not apply a 'one-size-fits all' approach to seeking feedback from interested parties, it should nonetheless apply a low threshold for consultation in these circumstances and make explicit reference to this intent in the Draft Consultation Charter (more specifically, Part 2, section 4, paragraph 4.2);
- BusinessNZ considers that it would be helpful to stakeholders if, in the interests of transparency, the Electricity Authority set out the principles by which the quality of its analytical work can be assessed. That is, a set of principles which will not be decision-breakers, but will inform how the Electricity Authority undertakes its day-to-day analytical role.

The principles outlined in the consultation paper appear to be more about the circumstances in which decisions should be made, for example, there needs to be a market failure, and in x or y circumstance, it is the preference of the Electricity Authority that the solution demonstrate a preference for markets, etc etc. The principles stated, while important, are largely mechanistic and do not necessarily speak to some key considerations that would assist in the development of robust, evidence-based policy work in the first instance. For example, they do not speak to the analytical framework within which it would determine the market failure in the first place (for example, carefully define the problem) or with the exception of the requirement to complete a CBA, the analytical process by which the Electricity Authority would reach its solutions (for example, consider all feasible options, match options to problems, be accurate, practical etc etc). In other words, the more qualitative aspects of the Electricity Authority's work. While perhaps a subtle distinction, BusinessNZ believes it to be a material one and worthy of careful deliberation. In this regard,

BusinessNZ is going to work on this aspect with its newly formed CEO Forum led Electricity Industry Group and it proposes to report to the Electricity Authority on its work early in the New Year. Given the high level nature of this information, BusinessNZ considers that it doesn't have to form a part of the consultation charter, but it is nonetheless critical to provide surety to market participants that the work of the Electricity Authority will not be unpredictable and ill-founded and therefore promote confidence in its work.

- finally, with respect to the consultation charter, better information, and scheduling of consultation processes is important to aid stakeholders manage their scarce resources. Therefore, BusinessNZ proposes that a new section be inserted into the Consultation Charter under the heading of "Consultation Calendar" outlining an obligation on the Electricity Authority to publish quarterly a calendar of forthcoming consultation processes. While this is not a statutory requirement, it is extremely useful to potential respondents in enabling them to manage their workloads more efficiently, or highlight impending consultation bottlenecks that need addressing.

Advisory Groups

In BusinessNZ's view, advisory groups as previously conceived were essentially simply sounding boards for the senior advisors. Advisory group members have little control over work programmes and are not accountable for the quality of their group's work. As a result, stakeholders have little incentive to 'take ownership' of the advisory group processes.

Despite a so-called advisory group review undertaken by the Electricity Commission, nothing of substance changed. As predicted by many at the time, the problem required a more fundamental "root and branch" reassessment of the operation of advisory groups than provided in the 'Advisory Group Review'. This document seems to provide this reassessment, and it is welcomed by BusinessNZ.

While broadly welcoming of the new approach to advisory groups, BusinessNZ does have a number of comments that it wishes to make. These are outlined in the following bullet-points:

- while implicit in many facets of the consultation paper, the paper (and the Charter) could benefit from a relatively simple and straight-forward statement of the role of the advisory groups. BusinessNZ proposes the following be woven into paragraph 2.2 and 2.3 of the draft prototype terms of reference for advisory groups:

The role of advisory groups as being to provide robust advice to the Board of the Electricity Authority, to enable the Board to make credible and workable recommendations to its stakeholders.

Such advice is to be delivered, as requested, in a manner that is timely, representative, accurate, innovative, well balanced and at the right level of detail.

BusinessNZ considers that the second element of this statement that sets out some high-level performance is particularly important given the Electricity Authority's heightened (and appropriate) emphasis on the accountability of the advisory group's for their performance;

- BusinessNZ welcomes the recognition, in paragraph 3.3.34, of the need to continue the Electricity Commission's practice of remunerating people or organisations that would be financially disadvantaged by their participation in an advisory group. The issues associated with consumer representation relate to skills and resources relative to other participants in the advisory groups. The Electricity Authority needs to make sure that consumer organisations are able to field representatives of a similar caliber to that of other organisations. Continued funding by the Electricity Authority at an appropriate level should enable these, if in deficit, to be bought in, in order to level the playing-field.

The issue then becomes representation *per se* and, in this regard, BusinessNZ appreciates that the position of consumers is no different to that of other participants who are not directly represented on advisory groups. In this case, the degree to which the Electricity Authority is effectively communicating the work of the advisory groups more broadly becomes important. The Electricity Authority needs to complement its engagement with consumers via the advisory groups with more targeted arrangements in order to facilitate more directly, a broader range of consumer views. It is unclear what happened to the suggestion of open consumer fora/workshops from the Electricity Commission's advisory group review, but BusinessNZ strongly supports the concept of open consumer fora/workshops similar to the model used by the Gas Industry Company;

- BusinessNZ welcomes the confidence being expressed by the Electricity Authority in giving the advisory groups significant responsibility in the management of its work programme. However, BusinessNZ also recognises that obligations to perform come with this added responsibility. Given the Electricity Commission's propensity to effectively disenfranchise the advisory groups, accountability was centralised to the Board. However, the new proposed approach effectively recognises that there are multiple levels of accountability for a variety of types of decisions. In doing so, it affords the benefit of treating the advisory group members as decision-makers. However, the added responsibility is not all one-sided. BusinessNZ expects that:
 - i. when considering issues, the advisory groups will be provided with analysis and recommendations which the advisory group can discuss and agree to, or not. This way a clear picture of the

views of the advisory group on a particular matter can be provided to the Board;

- ii. all views are canvassed in the analysis (including the Electricity Authority's view if different from the advisory group) in order for a full and informed debate to be held by the advisory group. If there are strongly held, but alternative views then these should be explained in the papers and accompanied by alternative recommendations. Advice to the Board should not be about criticising the choice made by the advisory group in order to sway the Board to the preference of the Electricity Authority staff, but instead, ensuring that information of a sufficient quality is put before the Board that would enable the Board to make an impartial, well informed choice between the competing alternatives. Separate reports should be discouraged unless only absolutely necessary. Paragraph 10.4 of the draft prototype terms of reference for advisory groups should be deleted;
- iii. in making option 2 (paragraph 3.3.4) work in practice, it is BusinessNZ's preference that the Authority staff act more in a support and collaborative role to the advisory groups rather than a watchdog-role advising the Board on the quality of the advisory group's analysis and recommendations. A collaborative role is implied in the description of the option and again in paragraph 3.3.37 and fulfilling this role properly would make it difficult for the Electricity Authority staff to then comment on the quality and performance of the advisory group especially if one of the options came from the Electricity Authority staff. Discussions on group performance should be between the Chair and the Chief Executive. The ultimate referendum on the quality of the advisory groups' analysis will come from the comments of submitters. In other words, accountability will appropriately come from their peers and it is this that will discipline the members of the advisory group to perform well and deliver what is required of it. BusinessNZ therefore suggests that consistent with this, paragraph 10.2 (f) be deleted along with any other reference to Authority staff reporting on performance. If paragraph 10.2 (f) is retained, then a mirror duty (for the Chair to report to the Board on the performance of the Authority Representative should be incorporated; and
- iv. it is also important, if the advisory groups are to determine the extent and type of analysis and feedback they undertake to make recommendations to the Board that they are adequately resourced, or realistic expectations placed on delivery timeframes. BusinessNZ notes that the draft terms of reference for the Security and Reliability Council (the 'SRC') contains an obligation on the Electricity Authority is responsible for ensuring that the SRC is resourced appropriately to perform its function

as described (paragraph 6.1), but that no such obligation rests on the Electricity Authority with regard to the advisory groups. There is a need to ensure that a disconnect doesn't develop between the expectations of the Electricity Authority and the resources available to the advisory group to deliver on those expectations. While BusinessNZ appreciates that regular meetings to discuss progress against the work plan are proposed, it considers that these should be at least quarterly, not half yearly;

- advisory groups, including the security and reliability council, need to operate in as transparent and open manner as possible. In particular, it is important not to unduly restrict the circulation of information between interested parties. For example, BusinessNZ is unclear whether the authority for members to:

“obtain input from within the organisation they are associated with”

would limit it from discussing papers with its members that have not yet been published on the Electricity Authority's website. The expectation set out in paragraph 17.4 of the draft prototype terms of reference for advisory groups of publication as soon as practicable after they have been circulated to members implies that any restriction on members from freely discussing the papers which whomever they wish would be inappropriate. Indeed in order to assist in the development of more robust outcomes, widespread discussion should be encouraged not discouraged. This should be clarified to reflect a presumption of circulation and discussion;

- there appears to be two disparate ideas in paragraph 11.5 of the draft prototype terms of reference for advisory groups. The first sentence relates to the expectation that advisory group members not carry out original research and analysis. The second sentence relates to the issue discussed immediately above about limits on circulation. These two ideas should be separated into stand-alone paragraphs;
- the Electricity Authority needs to ensure that its approach to advisory groups is flexible enough to accommodate the 'organic' emergence of industry and consumer initiated groups. The Electricity Authority will not have either the resources or the capability to address all of the issues of concern to industry stakeholders and the Electricity Authority should signal that, if it meets certain criteria (such as within its powers under the Act, consistent with its priorities and its objective), that the work of such groups can be utilised by it; and
- finally, the process for handling the non-performance of advisory group member's seems overly bureaucratic. The provisions have the appearance of having been translated from an employment contract and do not sit well with the voluntary participation on an industry

advisory group. The disproportionate nature of these provisions are notable given that there are no such provisions in the SCR terms of reference.

Summary

Based on these consultation papers BusinessNZ has high and positive expectations of the new Electricity Authority. BusinessNZ looks to these documents as providing a solid foundation of regulatory stability for the market going forward. However, despite this positive start, a number of refinements can be made to elements of all three consultation papers and BusinessNZ looks to the new Electricity Authority to clarify the matters BusinessNZ has raised before getting on the task of applying them in practice on a day-to-day basis.

Yours sincerely

A handwritten signature in black ink, appearing to read 'John A Carnegie', with a stylized, cursive script.

John A Carnegie
Manager, Energy, Environment and Infrastructure
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), BusinessNZ is New Zealand's largest business advocacy body. Together with its 63 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.